THE LONDON MONEY MARKET

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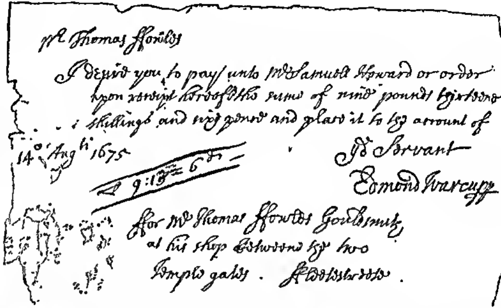
THE OLDEST CHEQUE


Mr Thomas ffowles

I desire you to pay unto Mr Samuell Howard or order upon receipt hereof the sume of nine pounds thirteene shillings and sixe pence and place it to the account of

14° Augt 1675

Yr Servant

Edmond Warcupp

£ 9:13 = 6d

For Mr Thomas ffowles Gouldsmith at his shop betweene the two Temple gates. ffleetestreete.

Through the courtesy of Mr. Ernest Sykes, B.A., of the Institute of Bankers, the Author is able to reproduce what is believed to be the oldest cheque in England. Unlike modern cheques, it bears the name of no bank, it has no stamp upon it, and there is no counterfoil. The wording of this ancient cheque is as follows—

Mr. Thomas ffowles

I desire you to pay unto Mr. Samuell Howard or order upon receipt hereof the sume of nine pounds thirteene shillings and sixe pence and place it to the account of

Yr. servant,
EDMOND WARCUPP.

14 Augt 1675.

£9. 13. 6.

For Mr. Thomas ffowles, Gould-smith at his shop betweene the two Temple gates, ffleetestreete.

On the back appears the following—

Recd. in full of this bill the sume of nine pounds thirteen shillings sixpence

SAML. HOWARD.

In view of its age—it dates from 1675—the cheque is in a very good state of preservation, though part of the edge of the plain white paper of which it consists is jagged. The ink, which was originally black, has faded to a somewhat drab tint, but the writing is perfectly legible. Thomas ffowles, the drawee, was one of the best-known *goldsmiths* who lived in the *time* of Charles II, and carried on business under the sign of the Black Lion. He was a Sheriff of London in 1686.

Frontispiece

THE LONDON MONEY MARKET

A PRACTICAL GUIDE TO WHAT IT IS, WHERE IT IS, AND THE OPERATIONS CONDUCTED IN IT

BY

WILLIAM F. SPALDING

FELLOW AND MEMBER OF THE COUNCIL OF THE INSTITUTE OF BANKERS, LONDON; FELLOW OF THE ROYAL ECONOMIC SOCIETY; ASSOCIATE, CITY OF LONDON COLLEGE; HON. MODERATOR IN BANKING AND CURRENCY TO THE LONDON CHAMBER OF COMMERCE

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SIXTH EDITION

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PREFACE
TO SIXTH EDITION

THE five years that have elapsed since the former edition of this book was published have coincided with a sustained, and on the whole, successful effort to foster and encourage recovery in the United Kingdom. This has been brought about by means of an enlargement of the credit base and the institution of an almost continuous regime of cheap and plentiful money. Indeed, interest rates have been lower than at any time during the past quarter of a century, and the trade and commerce of the country has derived incalculable benefits from this state of affairs. The period also includes a substantial recovery from the effects of the suspension of the Gold Standard in Great Britain, and marked stability in the exchange rates for the pound sterling. The story of the five years, too, includes the working of the Government's Exchange Equalization Fund, the establishment of which was a remarkable achievement. At first regarded as an experiment, its working has amply justified the hopes entertained by its introducers.

There have been many changes in the Money Market, alterations in the Fiduciary Issue of the Bank of England, variations in the method of fixing the price of gold, and other differences to record. These are described in the following pages and every effort made to bring the book up to date.

It only remains to express grateful thanks to the many

brokers, bankers, and others who have given ungrudging assistance and advice to the Author in the elucidation of the numerous problems that have arisen in that most absorbing of studies—The London Money Market.

W. F. SPALDING.

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Or—
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PREFACE
TO FIRST EDITION

The London Money Market and its ways have ever been an enigma to the man in the street; much of what goes on there has always been a closed book to those who are in daily contact with the market; yet a little study of what it is, and what is done in it, must surely prove what a wonderfully interesting heritage has been handed down to us by our forefathers. It needed the catastrophe of a great war to prove to the men and women of to-day that the money markets of the world are so closely interconnected that any dislocation in the central piece of the machinery—London—must inevitably react on all other parts of the machinery. Even so, comparatively few people are seized with a desire to acquire more than a superficial knowledge of the working of the money machine. They do not realize that London now holds a vaster market than has been. But there are exceptions, and for such this book has been written.

It embodies the results of some twenty years' practical experience of banking and monetary problems gained in that most useful of all places, the London office of a great banking corporation. A City bank, however, is hardly a school in which to acquire wisdom while you wait, and, unless what is learnt there is accompanied by wide reading many of the problems that arise daily will remain unsolved. The Author hastens to add, then, that throughout his banking career he has been a great reader of banking and economic literature; to this, no less than to his rubbing shoulders with the genial dealers in money, he owes the thoughts which in this book he endeavours to pass on to others.

That some apology may be required for publishing still

another work on the London Money Market he is well aware; but, as much of what appears in the following pages has formed the subject of discussions with bankers, bill brokers, merchants, and economists before whom he has had the good fortune to lecture in London and in the Provinces, it is sent forth in the hope that it will serve to make smooth the thorny paths which pave the way to a full understanding of our complicated money machine.

To the following, among the many good friends who have given the Author the benefit of their ripe experience and advice, he would like to convey his deep sense of gratitude—Sir Charles Addis, K.C.M.G., and the late Sir Newton Stabb, O B E, of the Hongkong and Shanghai Banking Corporation; to Mr. J. H. Absale, O B.E., late of the Bank of England; to Mr. G. J. Scott, Treasurer of the Bank of Scotland, and Mr. F. H Allan, Secretary of the Institute of Bankers in Scotland; to Mr. Clement J. G. Cooper, of Messrs N. M Rothschild & Sons; and Mr. H. L. Baggallay, of Messrs Pixley & Abell, for reading the pages and advising on points in connection with the bullion market; and no less to Mr. O. B. Granville, the father of the London Discount Market, who has placed freely at the disposal of the Author a half-century of experience on the London Discount Market. To all the City Editors of the great daily and weekly newspapers, to the Royal Insurance Company, and to Mr. A. J. Waterfield, grateful thanks are also due for giving the writer access to much ancient lore on "Old Lombard Street."

Last, but not least, the Author acknowledges the valuable assistance, extending over a long period, which he has received from that friend of all bankers, bank clerks, and students, Mr. Ernest Sykes, B.A., of the Institute of Bankers, London.

W. F. S.

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THE LONDON MONEY MARKET

CHAPTER I

WHICH INTRODUCES THE READER TO THE STUDY OF THE MONEY MARKET THROUGH ITS ORIGIN—MARKETS AND FAIRS

"Of making many books there is no end, and much study is a weariness of the flesh," said the old Preacher; and, had he lived in these days, he might have added: "Of markets also there is no end, and from the study of them may the god of commerce deliver us!"

The multiplicity, the complexity, and the ramifications of the markets of to-day are such that even the most earnest student of men and affairs may be forgiven if he sometimes abandons the attempt to understand what is their real function and purpose. In these days of mental lassitude it is so much easier to accept things as they are than to apply one's leisure moments in trying to trace out their origin and development. Yet, if we are to keep our pre-eminent position in the comity of nations, if we are to maintain the supremacy of London as the international monetary centre of the world, we must not recoil from the study of the most familiar link in the huge chain of markets with which this great city of ours is surrounded, even if the effort be a little wearisome.

Cynics have sometimes said that it is part of the Englishman's creed to leave it to intelligent foreigners to describe the objects of interest in his own land of commerce—a remark that has more than an element of truth in it. Indeed, even on this matter of money we have only to take a cursory glance round the library shelves of such places as the Institute of Bankers to find the *History of the Bank of England* written by Professor Andréadès, a

Professor in the University at Athens; and the *Rise of the London Money Market*, written by Dr. Bisschop, the Standing Counsel to the Dutch Legation. Both works may be regarded as standard books of their class. To describe the *City: July*, 1914–1915, was left to a Scandinavian, H. C. Sonne. Other instances might be given, but we refrain, lest the reader exclaim: "When do we come to your diagnosis of the London Money Market?"

One is often asked—

"What is the Money Market?"

"Where is it?"

"What do you do in it?"

"What was its origin, and when did it start?"

Now, as we have commenced this chapter by moralizing, it may not be a bad thing at this stage of our inquiry if we start by overhauling our intellectual furniture and endeavour so to take stock of our familiar business ideas on markets that, instead of shelving these oft-repeated questions until a more convenient season, we shall be in a position to answer them the next time they are put to us.

Very well, then, what is it that this word "market" conveys to us? Surely a place in which something is bought and sold!—some convenient spot at which a concourse of people may meet in order to exchange the comparatively superfluous for the comparatively necessary.

"But whence did the idea emanate?" asks the persistent inquirer.

To answer this question, we shall have to peep behind the veil of the long-forgotten past for a moment, since markets are of great antiquity.

Development of Markets and Fairs.

Markets and fairs are more than interesting relics of medieval times, and it will, therefore, be useful to trace their development from fairly remote periods.

In early Greece the market-place was called an *Agora*. Aristotle mentions the annual election of ten Athenian

Agoranomi, or market-masters, whose duties were to superintend the retail trade of Athens; to grant permits to strangers to engage in it; to test weights and measures and the quality of goods; and to settle summarily disputes between buyers and sellers. Traders were not the only denizens of the market-place. In them we also find the early Greek bankers holding a recognized position. They were called by the Greeks *trapezitae*, owing to the fact that they sat at tables in the market-places, which were the centre of all business transactions. The *trapezitae* acted as money-changers and, for a commission, exchanged the money of one country or province for that of another, or gave small local coin for heavy metallic money or gold.

Roman Markets.

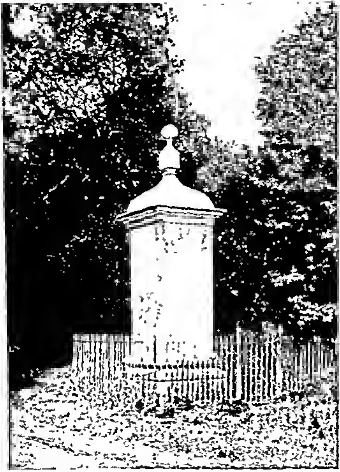
Among the Romans, markets were also of considerable importance. It was usual for the *praetors*, *propraetors*, and consuls to fix upon a convenient spot in the provinces for holding fairs and assembling the people for political purposes and for the administration of justice. These, says Servius, were at first called *conciliabula* (market-places); but, through the great concourse of people attracted to them, they were ultimately converted into *municipia* (boroughs or towns). Subsequently the creation of others was made possible by grants to villages, incorporations, etc. At an early period, however, markets tended to become centralized in Rome, much in the same way as we find the centralization of interests in London to-day. In Rome the markets for provisions and commodities were encircled with porticoes and houses, and, in general, the goods were exposed for sale in the Forum in shops and stalls; and here, in particular, the money-changers carried on their business. The *tabernae argentariae*, or banks, were set up in the Forum, especially about or under the three-arched buildings called Iani. Just as we have separate markets in our time, so in Rome were to be found separate centres for the sale of oxen, horses,

herbs, fish, bread, etc. They were called *fora*, the derivative *forum* being also applied to any space which formed the local centre of commerce and jurisdiction. On some of the coins of Nero, the fifth emperor of Rome, for instance, we find a good illustration of a *macellum*, or *macellarii* (a provision market or a meeting-place for provision dealers). The design shows a building adorned with columns, and having an entrance of four steps.

In Rome, the market day (*nundinae*) was every ninth day, or, according to our calendar, every eighth day. It was a general day of assembly and, in a sense, a religious festival. It is from Rome, perhaps, rather than from Greece, that we get the better idea of the origin of present-day markets, since by a process of evolution the practice of holding markets spread to Britain. The Roman Britons were quite familiar with markets; their market day was Wednesday, from its dedication to Mercury, the Italian god of commerce. Mercury, it may be remembered, was considered to be the protector of the corn trade, which was of such vast importance to the Romans, and because of this he was first publicly honoured in Rome by the erection of a temple near the Circus Maximus. At the same time a Guild of Merchants was established, the members of which were known as *Mercuriales*. With the spread of Roman commerce, the deification of Mercury extended far into the west and the north. The Roman Britons adhered to Wednesday for their market day for a considerable period; afterwards Saturday became the most usual day, in order that there might be leisure to attend to Sunday's duties.

English Markets.

The Greek *agora*, or market-place, in coast towns was usually to be found at the seaside, and in inland towns at the foot of the castle hill. Similarly, among the Anglo-Saxons, we find local markets instituted at first always on the neutral boundary between two districts. Boundary



BOUNDARY STONE AT MORETON-IN-MARSH

The old name was Morton-hen-Meare, "the place on the moor by the old boundary."

stones, which afterwards gave place to the more familiar and stately market crosses, denoted the places where these markets were held. At a still later period we find the markets directed to be held near the town gates. Cunningham, in his *Growth of English Industry*, gives a good example of these early market-places. He mentions one to be found in Moreton-in-Marsh, an ancient market town, situated on the boundaries of the four counties of Oxford, Gloucester, Worcester, and Warwickshire. It is recorded by a stone called the "four shires stone," to be found about a mile from the town on the London road. In the course of time we find market-places in England always developing in large open spaces within the city walls and not outside. In London, we have Cornhill, Cheapside, and Poultry as reminiscent of these old market-places.

The Control of Markets.

The control of markets has always been of importance. In Greece and Rome, as we have seen, the control was vested in the *agoranomi*, *propraetors*, and the like; and in the early days, in England we find town markets under the control of the lords of the manor and, later, governed by the corporations or merchant guilds, or both. The control exercised by the corporations and guilds was again similar to that undertaken by the Athenian market-masters, namely, the prevention of fraud, the safeguarding of the quality of goods, and the regulation of prices.

Fairs.

Fairs (Latin, *feriae*), concerning which much has been written, are perhaps not so important for our purpose as markets, as they belong to a very early stage of commerce, though it is necessary to refer to them in order to distinguish them from markets. They undoubtedly preceded the markets. In the early days, at any rate, they were merely temporary assemblages of traders, and they

differed from markets in being held only once or twice a year. They probably emanated from the large gatherings of traders at some common point for religious festivals or from political assemblages, since, as we have seen, early in civilization the two were practically identical. We find traces of fairs in the Anglo-Saxon period, when, as at Rome, they accompanied the political or religious festivals. In fact, the "place of holding a fair was often determined by religious considerations, such as the position of some shrine or holy place to which large numbers of pilgrims came."[1] The venerable little towns gathered around some of the Gothic churches which adorn the East Anglian coast are good examples. The existence of a Gothic church (says Dr. Ellis Powell) was the signal of settlement and progress. But besides these religious considerations, especially in fairs of later origin, "the special facilities of a central locality would determine the holding of the fair." Fairs were attended by merchants from all parts of the country, as well as by foreigners who came from various centres of Europe to sell their goods, and the period at which they were held was eagerly awaited as giving a much desired opportunity for commercial as well as religious or social intercourse.

In medieval England fairs were a necessity for two reasons: first, because owing to the economic distribution of the community over small villages or towns of barely 5,000 inhabitants, there was little means of a livelihood for the trader; secondly, in the fairs the inhabitants of the villages and towns could find a wider market for their produce and commodities, and more variety for purchase. "The result was that these fairs were frequented by all classes of the population from noble and prelate to the villein."[2]

The authority for holding fairs has always been jealously

[1] *Cf. Industrial History of England* (pp. 60–3), and *History of Commerce in Europe* (pp. 75–7). Dr. H. de B. Gibbins.
[2] Gibbins, *loc. cit.*

guarded, even down to the present time. Most of our market fairs were originally established by Royal Charter, a privilege which seems to date back to the period after the Norman Conquest, when the right to hold such gatherings was conferred by Royal grant, in return for payment, needless to say. To religious houses this right was frequently given. It was a fruitful source of revenue for them; but, in return for the power to levy tolls on those visiting the fairs, they were obliged to keep order. The King only was exempt from the tolls, though it is said his tenants in ancient demesne shared the privilege.[1]

English Fairs.

Of English fairs, that of Stourbridge is the best example, for it was the most important of all the fairs. Its fame extended far beyond the confines of our island home, and it was probably known in places where no European has ever been seen. We are told that not only was it a mart for European goods, but for Eastern produce—in short, for everything that could be bought at the time. Its origin is not known, but it was held near Barnwell monastery, about a mile from Cambridge, the corporation of which derived a revenue from it. An essential condition of the franchise of the time was the proclamation of a fair; consequently, Stourbridge was proclaimed on September 4, opened on the 8th, and then lasted for three weeks. Almost every conceivable commodity was bought and sold at this famous fair. Agricultural produce, live stock, numerous manufactured articles, books, ironmongery—in fact, everything for which England and the neighbouring countries were then famous—was on sale. Venetian, Flemish, Spanish, Levantine, Norwegian, Russian, and Grecian produce and manufactures were to be found there in abundance. The convenient accessibility of the fair—it was within easy reach of the two ancient ports of Lynn and Blakeney, and was accessible by the

[1] *Cf.* Thorold Rogers, *Six Centuries of Work and Wages.*

river from the sea—made it possible for foreign merchants from many countries to attend the fair.

In the circumstances, pedlars' or travellers' courts for the trial of disputes, which were a familiar feature of many of the old fairs, were probably of vital necessity to Stourbridge fair. They were popularly known as "Pieds Poudrés," or courts for the "dusty-footed." The name had reference to the summary nature of the proceedings in these crude courts. For any injury done or wrong suffered in the fairs or markets it was laid down that there should be as speedy justice for the advancing of trade and traffic as the dust could fall from the foot—the proceedings there being *de hora in horam* (from hour to hour). In them, the lords of the manor, or the mayor, like the Greek *agoranomi*, punished fraud and violence, and adjudicated upon disputes. Their protection in due course was readily extended to the foreign traders, who, on appealing to the courts, were often freed from oppressive restrictions, such as responsibility for each others' debts, with which they were ordinarily hampered.

Settlements of Foreign Exchange.

In these days, when we hear so much about foreign exchange, it is of interest to note the probability that these courts had sometimes to settle the equivalence of foreign moneys, or the just exchange between articles of foreign and those of home manufacture.

In the first instance, the aid of the Lombard exchangers, who were to be found at the fair, would be invoked to assist in the sale of the goods or to facilitate exchanges; but, if the parties were not satisfied with their decision, an appeal to the court would immediately follow and the dispute be summarily settled to the greater or less satisfaction of the disputants.

It is in these courts, held at the fairs, that we find the Law Merchant in its most characteristic vogue. The common law was not applied, for the reason that "the dealings

of the merchants necessitated the use of simple rules; no technical jurisprudence peculiar to any country would have been satisfactory to traders coming from many different countries. "It was necessary that there should be expeditious settlements of disputes, and summary executions to enforce decisions between buyers and sellers, who were strangers to each other, and who dispersed to distant places when their transactions were over."[1]

Decline of Fairs.

The advent of modern means of communication by rail and the development of commerce has led to the decline of fairs, though in the Middle Ages they were regarded as an integral part of the commercial life of Europe, and in the early days of trade in England they were certainly an important and very necessary element. Now they are relegated to a place among the interesting relics of our economic history, and at the present time, where still held, are doubtless regarded as an intolerable nuisance.

The last fair held in the City of London was that of St. Bartholomew, popularly known as "Bartlemy Fair." It was last seen in London in 1855.

The Origin of the Troy Weight.

Of foreign fairs there are many of importance and of interest, but of a bygone age we need note only the fair dating from Charles the Great's reign. It was held in Troyes in Champagne, and is interesting because it gave its name to the Troy weight, the standard which was evolved for reducing to a common denomination the numerous foreign coins that were found circulating in the Troyes fair.

We must not ponder longer over the historical details of fairs and markets, interesting as they are; but the reader will recognize that, in order to get at what we

[1] Smith, *Mercantile Law* (Vol. I; LXIX, LXX, 1890 Ed.), *cf. also* Powell, *Evolution of the Money Market.*

might call tbe true inwardness of things, it has been necessary briefly to refer to them.

Beginning of the Money Market.

In fine, it will be obvious that we have been looking for the ultimate origin of the Money Market in the assemblages at the boundary stones, at the market crosses, and within the environs of the monasteries. From the earliest times those who have something to sell have been wont to foregather at some such convenient spot with those who have the wherewithal to buy, and in their essential character there is really very little difference between the old market assemblages and the more sedate assemblages of money-changers and merchants that met daily at a later period (in the early sixteenth century) in their market-place, the space that is now Lombard Street. This assemblage was the prototype of our present-day Stock Exchange and Royal Exchange, to say nothing of the Baltic, the Corn Exchange, and such dignified meeting-places. Money dealers and their associates are now able to conduct their business in fairly comfortable surroundings, but they were not always so well provided for, since, just as medieval traders were forced to do their bargaining more or less in the open air, so the early Longobards, or Lombards, and other merchants, "strangers of divers nations," were forced to meet in that open and narrow thoroughfare (Lombard Street) for the purpose of making or adjusting their bargains. It fell to their lot to stand and to walk in the rain more like pedlars than merchants

The developments that have taken place since those "good old times" must form the subject of succeeding chapters.

CHAPTER II

LOMBARD STREET AND THE GOLDSMITHS—THE TRANSITION OF THE GOLDSMITH FROM MONEYLENDER TO BANKER

The strangers of divers nations mentioned on a previous page were, for the most part, composed of the Italian Longobards or Lombards. Their market, or meeting-place, Lombard Street, according to the Elizabethan historian Stowe, derived its name from their early association with it. They were not, however, the moneylenders to whom William of Normandy and successive sovereigns of the Norman period resorted for financial aid. William's *main source of revenue* was the *Jewish traders* who followed him from Normandy: they were established under royal protection in separate quarters or "Jewries" in the chief towns in England. In London the Jewish "exchange" was in the Old Jewry, and "it was the gold of the Jew that filled the Royal exchequer at the outbreak of war or of revolt: it was in the Hebrew coffers that the Norman kings found strength to hold their baronage at bay."[1]

The Old Jewries.

In 1290 Edward I issued an edict of banishment against the Jews in return for a grant of a "fifteenth" by the Parliament of the day. It was these Jews that the Lombards or wealthy Italian merchants from Florence, Venice, Lucca, and Genoa succeeded. However, as the result of the expulsion of the Jews, Edward I very soon found himself with an empty treasury, and there is no doubt that in his sore financial straits the Lombards were of great financial assistance to him. Edward II and Edward III are also known to have relied on them, and, as an indirect but valuable reward, the Lombards received

[1] Green, *Short History of the English People* (p. 87).

for their services comparative immunity from that strict system of surveillance to which foreigners of the day were subject. They practically escaped the harsh persecution which had been meted out to their predecessors, the Jews. The only restriction placed upon them was the obligation to reside in houses in the street which owes its name to their presence—Lombard Street. There are records extant of Edward II, in 1318, confirming a land grant in Lombard Street in favour of the Lombards, and it is therefore obvious that the initial grant had been given a good deal earlier.

To quote again the historian we have just mentioned: "Then you have Lombard Street, so called of the Longobards, and other merchants . . . assembling there twice every day, of what original, or continuance, I have not any record, any more than that Edward the Second, in the twelfth of his reign (1319), confirmed a Messuage, sometime belonging to Robert Turke, abutting on Lombard Street to the South, and towards Cornhill on the North, for the merchants of Florence; which proveth that street to have had the name of Lombard Street before the reign of Edward the Second."[1]

From their establishment in the "Street," then called "Langburnestrate" in the twelfth century (or before), the Lombards seem to have settled down to business. As accredited agents of the Papacy they seem to have been allowed to collect the dues from the English benefices held by foreigners. The money so raised was remitted by them by way of exchange to the Pope, the King having ordered that bullion must not be exported by the Nuncio. We may imagine, therefore, that they were experts in foreign exchange dealing. The Lombards performed useful service to England, since, from the funds at their disposal, they participated in the financing of British shipping and overseas trade.[2] They were left in undisturbed possession of the place for some 150 years, during which their ranks

[1] Strype, Vol. I, p. 475.
[2] *Cf. Twixt Lombard Street and Cornhill* (Lloyds Bank—London)

were added to from time to time by rich fugitives from the seething cities of Italy, where Guelph and Ghibelline were continually at war. They were doubtless assisted in their operations by a certain proportion of the Jews, who, despite the edict of 1290, had possibly remained behind to continue their business in conjunction with and under the guise of Lombards.

Meetings in Lombard Street.

The presence in this thoroughfare of the Lombards resulted, in the course of time, in the locality becoming a regular meeting-place of London merchants; and in the sixteenth century, Stowe says that these "merchants and tradesmen, as well English as strangers, for their generall making of bargaines, contracts, and commerce did usually meate twice every day; but their meetings were unpleasant and troublesome, by reason of walking and talking in an open street, being there constrained either to endure all extreamities of weather, viz., heat and cold, snow and raine, or else to shelter themselves in shoppes." In 1534, Henry VIII sent his letters to the City for the making of a new bourse at Leadenhall, but it was decided at a meeting of the Common Council that it would be inadvisable to remove the meeting-place from Lombard Street, and the proposal was therefore declined.

Office of Royal Exchanger.

Now, in the first instance, these Lombards were not actually money-changers, though they were moneylenders. Their essential business was trade in commodities, but it is to be assumed that they did carry on money-changing, in a limited way, as a kind of side line, or when incidental to their other operations. Moreover, a banking writer, in describing the period, says: "The Lombards, among other things, were the collectors of the Papal revenues, and drew bills on Italy against consignments of wool by which payment of Peter's pence was made in kind. At the same time they were engaged in the purely mercantile

business of buying English wool for export to Italy, and they drew bills of exchange in the ordinary way against such consignments."[1] It is evident, then, that, as they were cognizant of the utility of international bills of exchange, they must have been familiar with money-changing. Nevertheless, the actual business of money-changing itself was, in the early days of their domicile in Lombard Street, purely and simply a monopoly of the kings. It had been so before their advent. Henry I (1100–1135), John (1199–1216), Edward III (1327–1377), and successive sovereigns were all more or less instrumental in establishing the office of Royal Exchanger in London and elsewhere in this country. Old 'Change remains as historical evidence of this function or right vested in the kings. To the Royal Exchanger belonged the exclusive privilege of exchanging gold coins for silver and foreign for English money. The king farmed out the office, or shared in the profits accruing to the business, and the position in each town where the official followed his privileged calling was termed the "Exchange." It is to be observed that even these people were money-changers, not moneylenders. Moneylending, as we have said, was a monopoly of the Jews until 1290, when Edward I expelled them from England and the Lombards succeeded them. The Lombards, as we shall presently see, were quite as exacting as the Jews in the rates of interest they charged for accommodation. For example, there is a record in the *Liber Albus* of the City of London of a usury charge in which some of the Lombards were concerned. One of these gentry appears to have been the lender; another acted as a sort of discounter; while a third had been a "corrector," or broker legally appointed to record bargains made. The upshot of the transaction was an appeal by the debtor to the Court "that the horrible vice of usury by such evil devices may not run its course."[2]

[1] J. B. Martin in *The Grasshopper* (p 114)
[2] *Cf. The Grasshopper*, loc. cit.

Development in Credit.

Nevertheless, up to the end of the fifteenth century, there had been little development in credit, and even as late as the reign of Edward VI we find the accumulation of capital definitely discountenanced, if not forbidden.[1] But neither privilege nor prevention has ever availed against the commonwealth, and men very soon found means of evading unjust decrees or prohibitory legislation; they both hoarded their wealth and placed it with depositaries for safe custody, and the persons to whom they entrusted their money or valuables were to be found among the Lombards, or, as they were known later, the Goldsmiths, who in course of time were able to evolve a profitable method for using the deposits left with them.

Goldsmiths.

Just how, when, or where the term "Goldsmith," came into being it is difficult to say with accuracy. We are also unable to say with certainty whether at first the Lombards were goldsmiths, or whether the goldsmiths were a separate body The probability is that the profession of the goldsmiths was evolved from the early dealings of the Lombards in gold and silver plate, and that many Englishmen subsequently entered into the business Further, it is a reasonable supposition that the goldsmiths' profession arose from an early realization of the advantages to be derived from a division of labour; and just as the cabinet-maker followed the carpenter, the jeweller the blacksmith, the sculptor the mason, the wool-broker the wool-merchant, the bullion-broker the goldsmith, so the goldsmith himself followed or was evolved from the "general dealer," the Lombard. In a word,

[1] It was thought desirable that the wealth of any individual merchant, farmer, or artificer should be kept within very narrow limits · that no merchant should have more in land than £100; no farmer to be worth more than £100 or £200, or should have more than one farm or 2,000 sheep; and no labourer much more than was necessary for his expenses—*The Grasshopper* (p. 113).

separate branches of the trade carried on in Lombard Street became distributed among distinct classes.

Incorporation of the Goldsmiths' Company.

Of tbe antiquity of the profession in London there is ample proof, for definite records exist of the incorporation in 1392 of the Goldsmiths' Company of London by Richard II. Consequently, the division of interests took place at an earlier period; and we may be certain that in the ranks of the goldsmiths were to be found many of the Lombards and Jews who first congregated in Lombard Street.

As a matter of fact, we hear little about the doings of the London goldsmiths until Elizabeth's reign (1558–1603), when their profession began to assume really definite importance. It was customary in the Elizabethan age for the nobility to hold much of their wealth in the form of jewellery and plate, and the services of the goldsmiths were in constant request to find a place of safe keeping for these valuables. They were the custodians of much of the public wealth of the period, the only official place for safeguarding such treasures and cash being the Royal Mint on Tower Hill. The observant reader will constantly meet with references to transactions with goldsmiths in some of the old Romances. For example, in the *Memoirs of the Life of Mr. John Inglesant*, sometime servant to King Charles I, we read that, upon leaving London, John Inglesant had managed to get a sum of money transferred from one goldsmith, with whom he had deposited it, to another at Oxford "by a bill of exchange on the latter, as was the custom in transmitting sums of money in those days."

Just at this point it may serve to pave the way to a better understanding of the evolution of the money market of the period if we pause to take note of another important development in Europe. We refer to the formation of the Bank of Amsterdam. In the reign of James I, metallic

money, not only in England, but on the Continent, was in a very bad state. A great quantity of clipped, worn, and debased coin was current. Nothing much in the early stages was done in England to obviate the disadvantages arising out of this state of affairs. On the Continent it was otherwise. Amsterdam, which was then the international mart for the trade of Europe, had been experiencing grave disabilities owing to the influx of these inferior coins. This caused heavy depreciation in the value of the current money as compared with the freshly-minted Dutch money: the economic law—then little known—that bad money drives out of circulation the good money, was in full operation, and the good, full-weight coins tended constantly to disappear. The merchants under the obligation to meet foreign commitments, or to pay bills drawn upon them, found extreme difficulty in procuring sound coinage, or, indeed, any money acceptable to the holders of their bills. As a result, it was never quite certain what was the real value of the bills of exchange on either the Dutch or any other market

Formation of Bank of Amsterdam.

In 1609, in order to remedy these inconveniences, the Bank of Amsterdam was established under the guarantee of that city. "This bank received both foreign coin and the light and worn coin of the country at its real intrinsic value in the good standard money of the country, deducting only so much as was necessary for defraying the expense of coinage, and the other necessary expenses of management. For the value which remained, after this small deduction was made, it gave credit in its books. This credit was called 'bank money,' which, as it represented money exactly according to the standard of the mint, was always of the same real value, and intrinsically worth more than current money. It was at the same time enacted that all bills drawn upon or negotiated at

Amsterdam of the value of six hundred guilders and upwards should be paid in bank money; this at once took away all uncertainty in the value of those bills. Every merchant, in consequence of this regulation, was obliged to keep an account with the bank in order to pay his foreign bills of exchange, which necessarily occasioned a certain demand for bank money." [1]

Early Stages of Deposit Banking

There seems little doubt that the goldsmiths, being observant men, were immediately seized with the advantages to be derived from developing a business akin to that carried on by the Bank of Amsterdam. As both they and the Lombard merchants must have had many dealings with Amsterdam, it is conceivable that they availed themselves of the facilities granted by the bank It was, therefore, only a matter of time for them to realize the possibilities of what we now know to be the deposit system of banking. Not that either they or the Bank of Amsterdam at first understood the profitable advantages to both banker and client resulting from deposits; but they did perceive that it was indispensably necessary for the public to have something that would pass for good or honest money in the transactions between merchant and merchant.

As a matter of fact, the goldsmiths very soon began to make large profits by culling out heavy coins and selling them to the Dutch Mint. But Charles I, in 1627, rather queered their pitch by reviving by Proclamation the office of Royal Exchanger, which had fallen into disuse, and much of the business that had formerly been regarded by the goldsmiths as their special prerogative was diverted for the King's profit. This ancient office had been abolished by Henry VIII in 1539, as it was considered to have been a hindrance to trade; but Charles I revived

[1] Adam Smith, *Wealth of Nations* (Book IV, Chap. III, p 365 Routledge's Edition).

it with the pretended view of preventing the debasement of the coinage. He gave the office to the Earl of Holland for a period of twenty-one years. Charles, however, often resorted to methods which caused the public to lose all confidence in him. We have referred to the official place of safe keeping for public deposits of gold and silver plate and cash at the Royal Mint on Tower Hill. In 1640, Charles I, being in urgent need of funds, seized some £120,000 of the money placed in safe custody with the Mint, and this discreditable action led the merchants and others more than ever to entrust their money and valuables to the goldsmiths.

In the meantime, the goldsmiths were closely regarding the business done by the Bank of Amsterdam and, in some respects, began to model their operations on the lines taken by the bank. One of the old pamphleteers, writing in 1660, says: "The merchants of London have transported all the gold and most of the silver out of England, probably by the confederation and assistance of the goldsmiths in Lombard Street, who are just in the nature of the bankers at Amsterdam. . . . Some goldsmiths in Lombard Street keeping at this day many great merchants' of London cashes (*sic*) and some noblemen's cash: by this credit of other men's monies, the goldsmiths of Lombard Street are in the nature of bankers, and have a great stock of treasure by them always of gold, forraigne coines and silver."[1]

The New-fashioned Goldsmiths.

But it is from another tract, called the *Mystery of the New Fashioned Goldsmiths*, printed in the year 1676, that we get the most valuable account of the doings of the goldsmiths This particular tract is in the nature of a merchant's letter to a country gentleman who desired to apprentice his son to a goldsmith, and in it the author describes how the trade had wholly changed since his

[1] *Cf.* "An Appeal to Caesar" in *The Grasshopper* loc. cit.

time. At first, he says, the goldsmiths were entirely employed in selling plate, buying foreign coins and gold and silver. These they melted, culled, or sent to the Mint to be coined. Any surplus in their hands was sold to the refiners, plate makers, and merchants, due advantage being taken of the fluctuating prices of gold and silver and the demand from the merchants for foreign coins.

According to this old pamphleteer, it had been the custom for the merchants to impose upon their apprentices the duty of looking after their cash; but the advent of the Civil War giving the apprentices the opportunity of leaving their masters at will, the latter were led to deposit their cash with the goldsmiths, who thus began to receive the *money and, at first, to pay nothing for it, few observing* or conjecturing the profit they had for their pains. The trade in gold and silver plate had fallen into desuetude, and in this new business of receiving money upon deposit the goldsmiths found a much more lucrative field for gain.

Let us see what this pamphleteer has to say on the matter—his words are illuminating!

"It happened, about that time (1646) that the then Parliament had coined out of plate, and otherwise seven millions in half-crowns, and no mills being then used in the Mint, the money was of a very unequal weight, sometimes two pence or three pence in an ounce difference, and the French and others then changing the value of their coins often, which made silver and gold of much greater value abroad than at our English Mint. The goldsmiths found a new mischievous trade to send all the money trusted in their hands into their Cocklofts, where they had scales and various weights adapted for their purpose, and servants constantly weighed every half-crown (at least) and sorted them to melt for two pence or three pence, or sometimes less gain by the ounce, and sometimes their advantage being greater by the accidents of the rise or fall of the exchange, those heaviest coins were sent away in specie, several French men and other

merchants making it their whole and only business weekly to transport the gold and silver so culled, either melted down or in specie, and from hence the goldsmiths set up another new trade of buying old English gold coin at a rate much above its lawful coined value, buying and selling it at five, seven, eight and ten pounds in the hundred more than it was coined for, still sending it away . . . or supplying those with it whose business was to transport it, that by a moderate computation eight parts of ten of the coined gold was suddenly consumed, and two shillings a piece was commonly given for gold, when a penny a piece was often given before to exchange gold into silver, the seven millions also of silver new coined, was apparently reduced to less than one million, and the people so abused in the money, that there was little coin passed in trade but overworn, and clipt, to the great *vexation and loss of the traders.*

"These unlawful practices and profits of the goldsmiths, made them greedy to ingross all the cash they could, and to combine with all menservants who continued to keep any cash, to bring their moneys to them to be culled, and to remain with them at four pence the day interest per centum without the Masters' privity: And having thus got money into their hands, they presumed upon some to come as fast as others was paid away; and upon that confidence of a running Cash (as they call it) they began to accommodate men with moneys for weeks and months upon extraordinary gratuities, and supply all necessitous merchants that over-traded their stock, with present money for their bills of exchange, discounting sometimes double, perhaps treble interest for the time as they found the merchant more or less pinched.

"Profit arising by this trade, some of them who had the highest credit, undertook to receive gentlemen's rents as they were returned to town, and indeed any man's money, and to allow them some interest for it though it lay for a month only, or less, the owners calling for it by a hundred or fifty pounds at a time as their occasion and expences wanted it; this new practice giving hopes to everybody to make profit of their money until the hour they spent it, and the conveniency as they thought, to command their money when they pleased, which they could not do so when lent at interest upon personal or real security. These hopes, as I say, drew a great cash into these new

goldsmiths' hands, and some of them stuck to their old trade, but every of them that had friends and credit, aspired to this new mystery to become Bankers or casheers."[1]

Methods of the Goldsmiths to Attract Deposits.

From this quaint letter we get a mine of interesting information. It shows clearly that the London goldsmiths, having firmly established themselves in a lucrative calling, were not averse from following the lead given by the Bank of Amsterdam, though it is admitted that their methods were not anything like so scrupulous as those of the bank. They became money-changers on a large scale, and also made a very fine profit from the sale of the gold and silver coins they were constantly purchasing and melting down for the purpose. Their manner of attracting deposits was none too honest; they needed funds to carry on their business and were not too particular from whom or whence they obtained them, as witness the secret commission, or interest of 4d. per cent per day (about 6 per cent per annum) paid to the ubiquitous London apprentices against the deposit of their masters' money without the latter's knowledge or consent. However, it is important to notice that in the system they were developing, more or less unconsciously, lay the germs of the deposit banking which has brought London and its banks to the pre-eminent position they hold to-day. The goldsmiths' ways were crude, their charges exorbitant, but they were laying the foundations of the London Money Market as we know it to-day. In their simple way they were undertaking operations the like of which we see carried on around us at the present time: for they conducted exchange operations; bought and sold metallic money; advanced against security; accommodated merchants by purchasing their bills; and, last but not least, they opened current accounts which

[1] The complete pamphlet, which is in Old English, is printed as an Appendix to *The Grasshopper in Lombard Street*, by J B Martin.

were the genesis of the current accounts now kept by our modern joint stock bankers. Against their deposits they ultimately issued notes, and some of the goldsmiths even issued documents which are akin to our present-day cheques. There is, in fact, in possession of the Institute of Bankers, London, a document described as the "oldest cheque in this country," a reproduction of which will be found as our frontispiece. It was issued by Thomas ffowles, one of the best known goldsmiths of the reign of Charles II, who carried on business under the sign of the "Black Lion" He was a sheriff of London in 1686. The wording is—

Mr Thomas ffowles

I desire you to pay unto Mr. Samuell Howard or order upon receipt hereof the sume of nine pounds thirteene shillings and sixe pence and place it to the account of

Yr. servant,

Edmond Warcupp.

14 *Augt* 1675

£9 13 6

For Mr Thomas ffowles, Gouldsmith at his shop betweene the two Temple gates, Fleetestreete.

It is true that in the early stages of the business the goldsmiths paid no interest on the funds deposited with them. They may even have been regarded as public benefactors from the care they took of other people's money or valuables; but, whether they were gratuitous bailees or not, we soon find the goldsmiths turning into moneylenders. As their operations grew, we may presume that the hitherto unsuspecting clients became aware that what the goldsmiths were lending was other people's money, so interest came to be paid for the use of it. This started with the illicit payments made to the apprentices, then became more or less general, until we find the "running cash" business being conducted on a regular scale. As money went out, so more was attracted from other sources, until in course of time there was a regular

efflux and influx, for everyone was anxious to profit from the new system.

Discounting of Bills.

The money thus obtained was, as the author of the *Mystery of the New Fashioned Goldsmiths* shows, used for discounting bills and making advances at ruinously high rates of interest when the merchants were found to be "pinched." The goldsmiths' policy of offering interest on all deposits, whether the money remained with them for a month or less, was not according to modern standards a very safe one; the principle of allowing depositors to withdraw their money at will was even more hazardous, but it seems to have been uniformly successful up to a point, and certainly in the early days of the business it resulted in drawing "great cash into these goldsmiths' hands." Four years from the date of the publication of the pamphlet to which we have referred, we read of a person, Sir Dudley North, returning to London after a few years' absence and being surprised to find everyone depositing money with the goldsmiths.[1]

In the circumstances, it seems reasonable to give to the goldsmiths the credit for inaugurating the system of investment by deposit in banks, though they were not then known as bankers or their shops recognized as banks. Theirs, however, was not to be an unchequered career. Apart from the ordinary risks incidental to their trade or profession, they were soon to become the prey of impecunious monarchs to whom they were tempted to lend their surplus funds by the high rates of interest paid.

Appropriation of Funds.

The very reason for their accumulating large surpluses lay in the fact that Charles I had laid violent hands on some £120,000 deposited by London merchants in the Tower of London for safe custody. By this action the

[1] *Cf. Lives of the Norths* (Vol. II, p. 174).

merchants were driven to entrust their wealth to the goldsmiths on a far larger scale than had hitherto been the custom. The goldsmiths, in their turn, soon began to amass much more money than it was either safe or convenient for them to retain on their own premises. They were, therefore, practically obliged to find some means of placing their own balances in safe custody, so they elected to entrust them to the Government Exchequer. In fact, the Exchequer fulfilled very much the same function as the Bank of England does at the present time: the Bank of England is the bankers' bank; the Exchequer about the year 1660 was functioning as the goldsmiths' bank. From the practice of depositing their surpluses with the Exchequer there was evolved a system under which the goldsmiths maintained with the Treasury a sort of drawing account from which they drew once a week whatever sum was necessary to meet the calls made upon them by their clients. The Exchequer, as they afterwards found to their cost, proved to be but a sorry haven.

In 1672, Charles II, having provoked war with the Dutch, was in dire need of money. He was faced with the necessity of raising £1,500,000, and, it being impolitic or impossible for him to obtain Parliamentary sanction for such a loan, he cast about for ways and means to utilize the resources nearest to him. The goldsmiths' money was a tempting bait, so, in collusion with Sir Thomas Clifford, on January 2, 1672, he first of all closed the Exchequer, and then suspended payment of both principal and interest of loans advanced by the goldsmiths to the Treasury. In a word, he calmly appropriated £1,328,526 of the balances belonging to the unhappy goldsmiths—they had deposited the money with the Exchequer at 8 per cent per annum interest.

It was a shameless act, and in the view of most writers of the period it amounted to repudiation of the debt by the King, though Charles, with his usual effrontery, was ready with an excuse He said: "Considering the great

difficulty with which very many of our Loving Subjects (who putt their moneys into the hands of those Goldsmiths and others from whom we received it) doe at present Lye under, almost to their utter ruine for want of the said moneys, We have rather chose of our princely care and compassion towards Our people, to suffer in Our Affaires than that our Loving Subjects should want so reasonable a Reliefe."[1]

The difficulties to which Charles referred possibly lay in the need of the people for an honest medium of exchange; but the goldsmiths were in the habit of supplying something approaching this, albeit at an exorbitant profit, and so far from alleviating these difficulties by shouldering the burden, the King in his cynical indifference brought ruin on thousands of his subjects "Not merchants only, but widows, orphans, and others became suddenly deprived of the whole of their property. They came in crowds to the bankers, but could obtain neither the principal nor the interest of the money they had deposited."

Goldsmith Bankers' Debt.

The rectitude of the King and his ministers at this period was at a dangerously low ebb, but the fraudulent acquisition of the sum in question caused such an outcry from the public that even Charles was appalled. It was expedient, therefore, to call together those goldsmiths who had survived the crisis (many of them were bankrupt and utterly ruined, for they had lost their all), and on January 6, 1672, they were placated by a promise that payment would be forthcoming in about six months time. On that understanding, the solvent goldsmiths were persuaded to repay the deposits owing to the merchants. The King's promise, however, remained unfulfilled, for the principal sum was never repaid by Charles.

[1] *Cf.* footnote to *Evolution of Money Market* (p. 97), loc cit.; *History of the Stock Exchange*, Hirst (p. 29); Green's *Short History of the English People* (p. 639).

All that he did, eventually, was to grant a patent under which 6 per cent interest on the debt was to be paid out of his hereditary excise. He would not have done this had not *Parliamentary pressure been brought to* bear upon him. However, in view of the unstable character of the man, it is not surprising to find that he did not keep even to this agreement. A few years later, in 1683, he again suspended or repudiated payment.

A partial recognition of the debt was made in 1705, when the Government, under an Act which they had previously passed in 1701, agreed to pay 3 per cent on the capital sum of the goldsmiths' debt, with the right to redeem the whole at any time by payment of one half the amount originally lent. Yet, notwithstanding the Act of 1701, which authorized the charging of the hereditary excise with these interest payments, the principal of the "Goldsmith Bankers' Debt," as it was called, was never repaid; it was subsequently consolidated with the South Sea Annuities and now forms the first item of our National Debt.

We need not dwell further on this discreditable episode; but the "stop of the Exchequer," as it was known, is of great historical importance as marking the commencement of the English National Debt on the one hand, *and giving increased impetus on the other hand to* the movement for the foundation of a national bank in England.

The Father of Banking.

Public confidence in both the Government and the goldsmiths had received a rude shock, and an undercurrent of uneasiness soon began to manifest itself. Some of the goldsmiths seem to have realized that the old order was passing, and in course of time they gave up the actual goldsmith's business and became bankers pure and simple. Sir Francis Child, who has been referred to as the "Father of the Banking Profession," was about the first to abandon

the goldsmith-cum-moneylender trade. He had inherited a goldsmith's business which dated back to 1559, and some years after the "shop" came into his possession he seems to have come to the conclusion that it was desirable to specialize in the more select business of banking. The books of the firm, which are still in existence, show that, up to 1690, moneylending and banking transactions were all mixed up; after that date, the operations recorded were such as one would expect to find in the ledgers of any private banker.

Running Cash Notes.

The possibility is that Sir Francis Child, from whose house rose the well-known firm "Child's Bank," became apprehensive of the dangers underlying the issue of the "Running Cash Notes." As we have seen, the goldsmiths, originally depositaries, had developed into moneylenders; the security upon which they lent was usually pretty good, for they were canny persons. As Dr. Powell remarks,[1] they lent coin, or credit based on coin actually in their possession, in return for which a list was given specifying each article or amount deposited. This receipt, so far as the money was concerned, "was the running cash note, and the banker was the man who kept 'running cashes.'" It was not until the year 1770 that cheque books came into actual use.

"Goldsmith's Notes."

These "goldsmith's notes" really constituted the earliest form of English bank notes. Now and again the question of their transferability or negotiability arose, and we find that their assignable quality was strenuously objected to by Lord Chief Justice Holt in the reign of Queen Anne; but eventually they were made assignable, like bills, by the passing of a law to that effect. Until the goldsmiths discovered that their liability to pay back the

[1] *Evolution of the Money Market*, loc cit.

security on demand was somewhat remote, they appear to have issued notes only to the equivalent of the actual money deposited. Subsequently they realized that the demands for repayment were small; a negligible percentage of the gold deposited was required at any given time. Consequently, the system developed of issuing notes or promises to pay on demand to borrowers instead of lending them gold. It is evident from the manner in which these notes are mentioned in some of the old Acts of Parliament that they became "general and not special promises, or mere engagements to deliver a sum of money on demand, without conditions as to keeping a reserve for the purpose." For example, suppose one of these goldsmiths had received for safe custody from his clients £10,000 in gold or other valuables. In the early days of his banking business he would have issued notes for the £10,000, payable, at the will of the holder, on demand. Later, it became apparent to him that, provided he always kept the equivalent of, say, £5,000 in his vaults, he always had sufficient to meet the demands made upon him, since, while some clients would be withdrawing money, others would be depositing further sums. He conceived, therefore, the idea of utilizing the remaining £5,000 and, as we have seen, he lent out further sums of money, not in gold, but in notes; and experience having confirmed him in his surmise that he could eventually issue, say, £30,000 of these promises to pay without there being any particular danger of calls being made upon him, he proceeded to make full use of his balances by lending them to the Exchequer or other persons at high rates of interest.[1]

Sir Francis Child may or may not have realized the dangers underlying these unchecked issues of notes, but once he had separated the functions of goldsmith, money-lender, and banker, we find him carrying on a very careful business. The innovation by which he started as a banker

[1] For a full discussion on these "Notes," see *Functions of Money* (Chap VII, pp. 66, *et seq*), W. F Spalding (Sir Isaac Pitman & Sons London.)

—for it was an innovation in London at the time—was soon followed by others of his former profession, and in course of time there rose up a number of quite reputable private banking houses, many of which have survived to the present day, though their individuality is more or less obscured by their absorption by tbe great joint stock banks.

Passing of the Goldsmiths.

For the rest, it may be said that the act of repudiation by Charles II sounded tbe deatb knell of the goldsmiths as "botcb-potch" bankers and, with the exception of those firms of well-known probity who henceforward carried on a separate and distinct banking business, they tended to drift back into tbeir original trades, some as goldsmiths, some as silversmitbs, some as bullion brokers, some as pawnbrokers, to say nothing of the moneylenders

Nevertheless, their operations, as we bave pointed out, clearly demonstrated the need for a central institution, which, while it could act as tbe medium for Government finance, could yet be trusted to take cbarge of the people's money without fear of repudiation. The goldsmiths had evolved a definite market in which money could be bought and sold, lent and borrowed, and it remained for a more powerful body to build upon the foundations they had laid. The time was ripe for the establishment of the Bank of England, whicb, as we shall now see, very soon became, and has since remained, the central point around which the London Money Market revolves.

CHAPTER III

THE CORNER-STONE OF THE LONDON MONEY MARKET—THE BANK OF ENGLAND: ITS ORIGIN AND DEVELOPMENT—THE BANK OF ENGLAND RETURN ANALYSED

THE mystery surrounding the actual date of the establishment of the goldsmiths as bankers in London has afforded a good deal of ground for conjecture, and much has been written on the subject. One of the old authors went even so far as to affect to have discovered the solution of the so-called mystery;[1] but, notwithstanding the researches into the matter, it has to be admitted that the evolution, or the transition from goldsmith to banker, was so gradual as to have passed practically unnoticed. The goldsmiths seem to have first adopted the title "banker" during the reign of Charles I, the name being derived from the Italian word *banco*, meaning a mound or pile in the sense of "money"[2] However, it was only when something in the nature of practical banking business was being done on the London market that people began to inquire whence the new profession emanated. In fact, down to as late a date as 1746, we find a speaker in the House of Commons asking what it is that is called a "banker." "There is," he said, "in this city a company or corporation called goldsmiths, and most of those called bankers are of that corporation; but, so far as I know, there is not a company or corporation in England called bankers, nor has the business any definition or description either by common law or by statute. By custom we call a man a banker who has an open shop, with proper counters, servants, and books, for receiving other people's money, in order to keep it safe, and return it upon demand; and when any man has opened such a

[1] *Cf The Mystery of the New Fashioned Goldsmiths; or, Bankers Discovered* (London, 1676).

[2] *'Twixt Lombard Street and Cornhill* Loc cit.

Copyright [illegible] (Painted by G. Harcourt [illegible] Royal Exchange

FOUNDING THE BANK OF ENGLAND

George Harcourt's mural fresco, "Granting the Charter for the Foundation of the Bank of England (1694)," is one of the series of panel paintings illustrating the development of commerce, liberty, and education which adorns the arcades of the Royal Exchange

shop, we call him a banker, without inquiring whether any man has given him money to keep or no; for this is a trade where no apprenticeship is required, it having never yet been supposed that a man who sets up the trade of banking could be sued upon the statute of Queen Elizabeth, which enacts that none shall use any art or mystery then used, but such as have served an apprenticeship in the same."[1]

There is, however, no mystery about the central piece of the machinery of our great money market—the Bank of England—the date of whose establishment can be clearly fixed. It is beyond the scope of this work to enter into a long account of the foundation of the bank and its subsequent history, but a few details in regard to its commencement may be of interest.

William Paterson's Plans.

Proposals to form a central bank had been many times before the British Government, but for various reasons, chiefly political, nothing was definitely accomplished until an energetic and adventurous Scot, William Paterson, took the initiative. This was in 1691. But, prior to that period, Paterson had had a successful business career; and, when in 1691 he sought the assistance of one or two London merchants for the development of his project for the foundation of the Bank of England, he was a comparatively rich and influential man. He was much interested in banking and the customs of Lombard Street. In 1693 we find him prominently before the public. There was a dispute in connection with the "goldsmiths' notes," and it had been decided in the Courts that these "writs," being promissory notes and not bills of exchange, were illegal; they could be neither assigned nor transferred. Lord Holt in the Court of Queen's Bench declaimed against the obstinacy of the merchants, who, he said, were

[1] *Cf. Gilbart and Others on Banking* (Section I, p 3). The speech was delivered in the House of Commons in 1746, and was printed in the *London Magazine* for that year (p. 120).

setting up the law of Lombard Street above that of Westminster Hall. The decision was a severe blow to London bankers and merchants, and Paterson keenly associated himself with a remonstrance that was drawn up and sent to Parliament. When be took up the cudgels on behalf of the goldsmith bankers and others, he realized that the golden key unlocks most doors, and we find him with characteristic shrewdness appearing before a Committee of the House of Commons in 1693, calmly offering to raise money for Government use by means of his influence with City financiers; but on this condition, that the Government as a *quid pro quo* should sanction the goldsmith bankers' "bills payable in coin on demand" being made transferable to bearer without indorsement. This was in direct variance with Lord Holt's decision. He was not immediately successful, despite the tempting bait he held out; but a few years later, in 1704, an Act (3 & 4 Anne, c. 8) did accord to English promissory notes the same rights as bills of exchange, and to Paterson belongs the credit for paving the way for this piece of legislation.

Founding the Bank of England.

Returning to the consideration of the founding of the Bank of England, we find that Paterson's first effort was to interest the Government of the day in his scheme, but he was only partially successful, for, beyond getting one of the Treasury Commissioners, a man named Montague, to champion his cause, nothing much was accomplished. Nevertheless, the seed had been sown, and it was soon to bear fruit. The ground was carefully prepared during the next two or three years, and when William III was in need of funds for the prosecution of the war with France the time was deemed ripe for the furtherance of Paterson's plan. Montague was a powerful ally, and as both he and the King had in the meantime frequently availed themselves of Paterson's advice and assistance in financial affairs, not much opposition was likely from that

quarter. The King, naturally, was deeply interested in all suggestions for the replenishment of his exchequer; there was an acute scarcity of ready money, and England was then entering upon a period subsequently called "King William's seven years of famine." In 1694, William was so hard pressed for funds for continuing the war with France that means seem to bave been taken to secure Government support for Paterson and his associate to launch their scheme. There were, however, many obstacles to be overcome; considerable discussion was necessary before political objections to the formation of the new bank were brushed aside, but eventually Parliamentary authority was obtained and recorded in the passage of a Bill which passed the legislature under the title of the Tunnage Act. This Act is somewhat of a curiosity, but, notwithstanding the peculiar method employed to circumvent objections, it was sufficient for the purpose which it achieved. It read—

> "An Act for Granting to their Majesties several rates and duties upon tunnages of ships and vessels, and upon beer, ale and other liquors; for securing certain recompences and advantages in the said Act mentioned, to such persons as shall voluntarily advance the sum of fifteen hundred thousand pounds towards carrying on the war against France."

Charter of Incorporation.

There were other clauses in the Act giving the Government power to levy various taxes, etc., but the most important was the authority the Act gave for the raising of £1,200,000 by voluntary subscriptions. As a reward for their loyalty and financial aid it directed that subscribers should be incorporated under the style of "The Governor and Company of the Bank of England," a title which has survived down to the present day. The remaining £300,000 provided for in the Act was raised by subscription, and in return for it annuities were granted to subscribers.

The public took kindly to the project, and the money was soon forthcoming. The success of the flotation made the issue of a Charter of Incorporation a foregone conclusion; consequently, on July 27, 1694, the Government signed the said Charter, and business was commenced in the Mercers' Chapel.

We need not quote the Charter in full, but some of the principal provisions are important. It was decreed that—

"The management and government of the corporation be committed to the governor, deputy-governor, and twenty-four directors, who shall be elected between the 25th day of March and the 25th day of April each year, from among the members of the company duly qualified.

"That no dividend shall at any time be made by the said governor and company save only out of interest, profit or produce arising out of the said capital stock or fund.

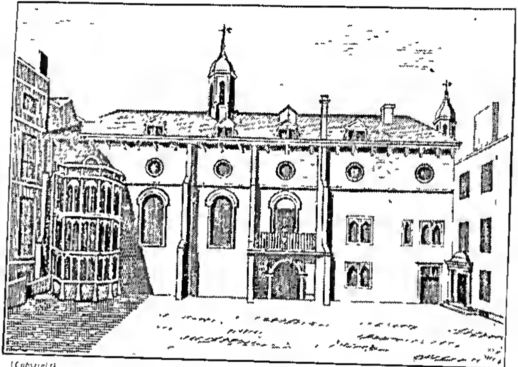
"They must be natural born subjects of England, or naturalized subjects; they shall have in their own name and for their own use, severally, viz., the governor at least £4,000, the deputy-governor £3,000, and each director £2,000 of the capital stock of the said corporation.

"That thirteen or more of the said governors or directors (of which the governor or deputy-governor shall be always one) shall constitute a court of directors for the management of the affairs of the company."[1]

Beginning of Funded Debt.

The sum advanced to the Government by the founders of the Bank, £1,200,000, is interesting as marking the commencement of the Funded Debt of the United Kingdom: it was also the first capital of the Bank of England, and against it the Bank was allowed to issue, in the first instance, notes to an equivalent sum. The policy followed by the Bank in regard to its notes was, as a matter of fact, in many respects similar to that adopted by its predecessors, the goldsmith bankers. Professor Marshall

[1] *Gilbart on Banking* (Vol I, pp. 32–3).



[*Copyright*]

OLD GROCERS' HALL

The business of the Bank of England was first transacted in Mercers' Chapel (erected on the site of the house where Thomas Becket was born), and from 1695-1734 in Grocers' Hall. The London Grocers' or "Pepperers'" Guild is mentioned in 1180.

(B 1844)

has succinctly described the position in these words: "It purported to give in its bills the equivalent of what it received, but it never pretended to take the deposit for any other purpose than that of trading with it. It never professed to make its issues square exactly with its coin and bullion, though, of course, it made its liabilities square with its assets, plus the capital of its shareholders, and in time, plus its rest or reserve also, i.e. its accumulated and undivided profits. At first these profits were derived from the dividends it received from the Government, and from the gains it made out of the notes which it put into circulation in exchange for, or in addition to, the cash which it took."[1]

The issue of the Bank of England's notes was at first accidental, that is not essential to the working, and for very many years they were not legal tender; the Bank also paid interest on them at the rate of twopence per day. They were, therefore, not in popular use for making payments, and they were wanting in one of the chief essentials of a well-managed money—they lacked fixity of value Their convertibility, too, was not definitely assured and they were made payable to order, not to bearer. In the circumstances it is not surprising to find that the Bank was often in sore straits to maintain its credit, and its difficulties were largely concerned with its note issue Within three years the Bank had to suspend payment of its notes in cash and, although various improvements were made and safeguards adopted, the Bank was subsequently faced with similar crises.

The First Bank Act.

The Charter of 1694 was amended from time to time, but for some 150 years the amendments do not seem to have been stringent enough to limit the Bank's issues of notes. The amount put into circulation and also the reserve kept against the notes was largely a matter for

[1] *Elements of Political Economy* (p 296)

the discretion of the directors. A similar state of affairs prevailed in regard to the note issues of other banks; and financial panics, coincident with the suspension of cash payments, were of such frequent occurrence that the Government ultimately was forced to take action.

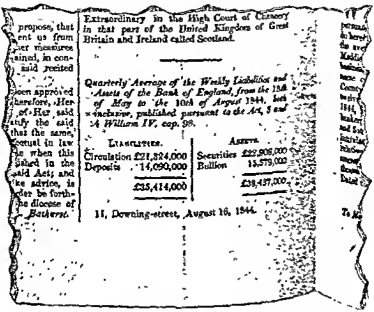
In the early years of the Bank's working, little or no information was given to the public. But, ultimately, under the Bank Act of 1833 (3 & 4 William IV, cap. 98) the Bank was required to publish regular returns. This particular Act laid down—

"That an Account of the amount of Bullion and Securities in the Bank of England belonging to the said Governor and Company, and of Notes in Circulation and of Deposits in the said Bank, shall be transmitted weekly to the Chancellor of the Exchequer for the time being, and such accounts shall be consolidated at the end of every month, and an average state of the Bank Accounts of the preceding three months, made from such consolidated accounts as aforesaid, shall be published every month in the next succeeding *London Gazette.*"

By the courtesy of the Midland Bank, Limited, we reproduce a photograph of the last Return to appear in the *London Gazette* under the Act of 1833. It is curious in this published account to find that the total liabilities are less than the total assets by £3,073,000. The reason for the account not balancing was, that on the liabilities side the Bank's capital and rest were omitted, and on the assets side an amount of securities corresponding to the capital was excluded. As the Act of 1833 did not call for the inclusion of the capital and rest, the Governors of the Bank kept to the letter of the law and left them out.

After almost interminable discussion in Parliament— and outside—the controversy in regard to the right to issue notes culminated in the passing of the Bank Charter Act of 1844 (7 & 8 Vict., cap. 32). This particular piece of legislation is known as "An Act to regulate the Issue of Bank Notes, and for giving to the Governor and Company of the Bank of England certain Privileges for a limited

Period." It was dated **July 19, 1844**. Sir Robert Peel, who had previously been instrumental in getting passed a Bill for ensuring that bank notes should be payable on demand in gold, was largely responsible for the Act of 1844. His former Bill had proved in practice to be a failure, but the experience gained in its working stood him in good stead.


Extraordinary in the High Court of Chancery *in that part of the United Kingdom of Great* Britain and Ireland called Scotland.

Quarterly Average of the Weekly Liabilities and Assets of the Bank of England, from the 18th of May to the 10th of August 1844, both inclusive, published pursuant to the Act, 3 and 4 William IV. cap. 98.

LIABILITIES.		ASSETS.	
Circulation	£21,324,000	Securities	£22,908,000
Deposits	14,090,000	Bullion	15,579,000
	£35,414,000		£38,437,000

11, Downing-street, August 16, 1844.

He realized that the bank notes of his period really formed part of the national currency, inasmuch as they were practically irrefutable; consequently, he determined to treat them as being not private but public instruments of credit. Hence his Act, which signified the acceptance of the principle that the right of regulating the issue of currency was inherent in the State. He was, in fact, so keenly apprehensive of the dangers of excessive note issues when left in the hands of bankers that the principal feature of his subsequent legislation, which found expression in the Bank Charter Act of 1844, was the regulation of the issue of "Bills or notes payable on demand"

Under the terms of the Act, Peel made it obligatory upon the Bank of England to keep its Banking Department and its Issue Department entirely separate, and to all intents and purposes the management of the note issue has ever since been a function distinct from all others of the Bank

In brief, the effect of the Act was to make the future note issue of the Bank of England largely a matter of routine, for, under Section II, the Banking Department was ordered to transfer on August 31, 1844, to the Issue Department, securities to the value of £14,000,000, part of which was represented by the Government debt of £11,015,100, and so much of the gold coin and gold and silver bullion as was not required by the Banking Department. These represented, so to speak, the assets of the new department. As liabilities, under the same section, the Issue Department was directed to take over from the Banking Department such an amount of Bank of England notes as, together with those in circulation, was equal to the aggregate amount of the securities, coin, and bullion transferred to it.

The total amount of Bank of England notes in circulation, including those delivered to the Banking Department, was deemed to be issued on the credit of the securities, coin, and bullion so transferred.

It was also laid down that the silver held in the Issue Department must not exceed one-fourth part of the gold deposited in that department.

Limitation of Note Issue.

The effect of the Act, then, was also to limit the issue of the bank notes as against securities to £14,000,000; all notes issued in excess of that amount had to be covered by gold or silver coin or bullion.

It was further provided in Section V of the Bank Charter Act that if any banker who was issuing notes on May 6, 1844, ceased to issue his own bank notes, the

Bank of England should be empowered to issue additional Bank of England notes against securities to an amount not exceeding two-thirds of the amount of the notes withdrawn from circulation by the banker ceasing to issue.

Bank of England Return.

Section VI of the Bank Charter Act of 1844 is the one with which we are mainly concerned in our study of the London Money Market. It provides for an account to be rendered weekly to the Commissioners of Stamps and Taxes in a prescribed form. The particulars required to be shown are—

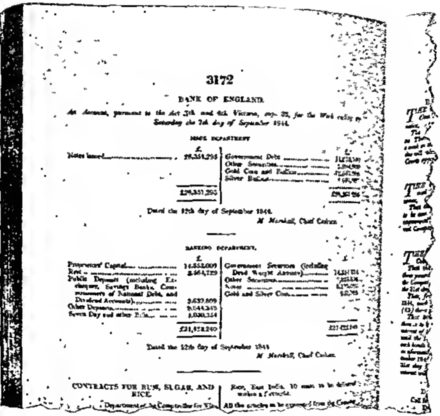
(i) For the ISSUE DEPARTMENT—an account showing the amount of Bank of England Notes Issued by the Department; the amount of gold coin and of gold and silver bullion held by the Department, also the amount of securities held.

(ii) For the BANKING DEPARTMENT—an account showing the Capital stock, the Deposits, and the money and securities belonging to the Bank of England.

The two accounts comprise what is known as the Bank of England Return. It is issued each Thursday, and copies are freely available to the public on that afternoon shortly after 2 p.m. Consequently, every Thursday afternoon it is the custom in the City for a crowd of bankers, discount and other brokers, and newspaper representatives to wend their way to the Chief Cashier's office of the Bank of England. On the counter there they find a neat little box which contains a plentiful supply of copies of the Return. Just behind the box is displayed a sheet of paper on which is shown certain mystic figures—they represent the ratio which the Bank's Reserve bears to its Deposits. Before the War, the Reserve used to vary between 40 and 50 per cent of the Deposits; nowadays it is somewhat less. Representatives of the banks, the brokers, and the newspapers walk into the Chief Cashier's

office, help themselves to copies of the Return, copy down the percentage position of the Reserve which the Bank officials have kindly worked out for them, and then quickly pass out through the gloomy portals of the Bank. With this information in their hands, the denizens of the London Money Market have sufficient to keep their minds busy for the rest of the day. The Bank Return affords abundant material for gossip in the bank parlours, in the discount brokers' offices, or in the more humble and congenial atmosphere of the nearest tea-shop—to say nothing of the busy City Editor's office. In his turn, the newspaper writer has the wherewithal for a useful column of "copy" to be displayed and commented upon in either the evening or the morning paper. It follows that the outside world, which knows little and, it is to be feared, often cares less about these things, soon gets the benefit of more or less expert opinions on the monetary position of the Bank and of the Government. A poor clerk once said, "The Bank Return is what one likes to read into it," and certainly it does seem to afford ample scope for both the optimists and the pessimists. The Return appears to be taken as a standing invitation to praise or to condemn. On the one hand, we get those unhappy people who affect to see in a drop in the ratio of Reserve to Deposits a sure and certain sign that the Bank and the country are "going to the dogs"; on the other hand, we meet the cheerful individual who constantly finds that things are not so bad as they might have been, and who hazards the opinion that the next week's Return will show up better; and so it goes on One is tempted, in fact, to wonder what the City would do without its weekly chronicle of the doings of the dear "Old Lady of Threadneedle Street."

Well, in order to arrive at a correct understanding of the manner in which this Return is scrutinized and criticized, it will be necessary to take one of the weekly accounts and to analyse each item step by step. We shall then, perhaps see what it really does mean to convey.



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BANK OF ENGLAND.

An Account, pursuant to the Act 7th and 8th Victoria, cap. 32, for the Week ending on Saturday the 7th day of September 1844.

ISSUE DEPARTMENT.

	£		£
Notes issued	28,351,295	Government Debt	[illegible]
		Other Securities	[illegible]
		Gold Coin and Bullion	[illegible]
		Silver Bullion	[illegible]
	£28,351,295		£28,351,295

Dated the 12th day of September 1844.

M. Marshall, Chief Cashier.

BANKING DEPARTMENT.

	£		£
Proprietors' Capital	14,553,000	Government Securities (including Dead Weight Annuity)	[illegible]
Rest	3,564,729	Other Securities	[illegible]
Public Deposits (including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts)	3,630,809	Notes	[illegible]
Other Deposits	8,644,348	Gold and Silver Coin	[illegible]
Seven Day and other Bills	1,030,354		
	£31,423,240		£31,423,240

Dated the 12th day of September 1844.

M. Marshall, Chief Cashier.

CONTRACTS FOR RUM, SUGAR, AND RICE.

[illegible] Department of the Comptroller for Vict[illegible]

Rice, East India, 10 tons, to be delivered within a fortnight.

All the articles to be [illegible] from the Country [illegible]

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BANK OF ENGLAND

AN ACCOUNT pursuant to the Act 7 and 8 VICT. cap. 32, for the Week ending on Wednesday, the 21st day of November, 1928.

ISSUE DEPARTMENT

	£		£
Notes Issued . .	180 964 085	Government Debt	11 015 100
		Other Securities	8 734 900
		Gold Coin and Bullion. . . .	161 214 085
		Silver Bullion .	——
	£180 964 085		£180 964 085

Dated the 22nd *day of November*, 1928.

C. P. MAHON, *Chief Cashier*

BANKING DEPARTMENT

	£		£
Proprietors' Capital	14 553 000	Gov^t Securities .	48 340 327
Rest	3 204 147	Other Securities .	34 757 491
Public Deposits— (including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts)	14 898 189	Notes	48 161 710
Other Deposits .	99 472 105	Gold & Silver Coin	870 504
7 Day & Other Bills	2 591		
	£132 130 032		£132 130 032

Dated the 22nd *day of November*, 1928.

C. P. MAHON, *Chief Cashier*

Form of Return.

The first Return to be issued under the Act of 1844 was dated September 12, 1844, and on page 43 is a photo graph of the actual Return published in the *London Gazette*.

The Bank Return appeared in this form up to November 21, 1928, and as will be seen from the following details of the account issued for that date, with the exception of variations in the figures, there was no alteration in the method of presenting the statutory details of the Bank's position.

As a point of historical interest it may be mentioned that this Return for the week ended November 21, 1928, was the 4,396th of the series, and before examining the type of Return issued at the present time, it will be useful to analyse the items.

"Notes Issued."

In the account representing the position of the Issue Department, the only item on the debit side is "Notes Issued, £180,964,085." This is self-explanatory: it represents the notes issued against the cover set out on the other side of the account.

"Government Debt."

The first item on the Credit side is the amount of the Government Debt to the Bank, £11,015,100. It will be remembered that the original amount of that debt to the Bank incurred by the Government was "fifteen hundred thousand pounds." During the interval of 150 years between the foundation of the Bank of England and the passing of the Bank Charter Act, sundry additional advances, amounting to £9,515,100, were made by the Bank to successive Governments, and these, added to the original loan of £1,500,000, make up the present sum of £11,015,100 due by the State to the Bank of England There is no actual Government Stock representative of

this amount: it simply exists as a book debt on which the Government pays $2\frac{1}{2}$ per cent. per annum interest to the Bank. Section II of the Act is the clause which is important in this connection. It laid down the amount of the Bank's authorized issue against securities, and fixed a limit of £14,000,000, of which the Government Debt, £11,015,100, is permitted to form part. Up to £11,015,100, then, as Clare points out,[1] the Bank's note issue is guaranteed by the Government, and in every way corresponds to a State issue. For every additional note beyond the sum of £14,000,000 that the Issue Department puts into circulation it was enacted that gold should be deposited in the vaults.

"Other Securities."

It will be observed, however, that the sum under "Other Securities," instead of standing, as it did in 1844, at £2,984,000, amounted to £8,734,900, which, plus the Government Debt security, made a total of £19,750,000 as the sum for which the Issue Department was responsible, and against which it had to hold convertible securities.

This part of the note issue, known as the Fiduciary circulation, had risen from the £14,000,000 which Sir Robert Peel fixed as a safe minimum for the Bank to keep in circulation against securities to the amount at which it then stood by reason of the Governor and Company having taken up a proportion of the lapsed issues of country banks. Country bankers who on May 6, 1844, had the right to issue notes, were permitted to continue their circulation under certain well-defined and stringent regulations; but, under Section V of the Bank Charter Act, it was provided that if any of them ceased or forfeited the right of issue, then the Bank of England might make application to the Government for power to increase the securities in the Issue Department, and to issue additional notes against them. The proportion, however, in

[1] *Cf. A Money Market Primer* (p. 15).

no case was allowed to exceed two-thirds of the amount of bank notes which the banker so ceasing to issue may have been authorized to issue under the Act. The Bank of England has from time to time availed itself of this privilege and, as will be seen from the above-mentioned total, £19,750,000, since 1844 it had increased the amount of its Fiduciary circulation by £5,750,000. But this amount, does not represent fully two-thirds of the issues that have lapsed.

Last Private Bank Note Issue.

Since the first edition of this book was written, however the issues of the country banks have lapsed by reason of their amalgamation with or absorption by the great joint stock banks; and, as a matter of interest, it might be noted that the last bank possessing the right to issue its own notes was that of Messrs. Fox, Fowler & Co, of Wellington, Somerset, which amalgamated with Lloyds Bank, Limited, in 1921, and so forfeited its note-issuing privileges. Early in 1923 the Bank of England appears to have considered it advisable to avail of the right, conferred upon it under Section V of the Bank Charter Act, to increase its Fiduciary issue by taking up the legal quota of lapsed issues. The required application was made to the Government, and on February 13, 1923, the Bank was given permission to increase its Fiduciary note issue from £18,450,000, at which it was fixed in 1903, to £19,750,000 The Fiduciary circulation of the Bank of England in 1844 was, as we have seen, £14,000,000; the authorized note circulation of the country banks was £8,631,647, consequently the Bank of England's Fiduciary issue had, on November 21, 1928, now, in round figures, reached the limit contemplated by the Act of 1844

Growth of the Fiduciary Issue.

The growth in the Fiduciary issue of the Bank of England since 1844 and before an amalgamation of the

Government's Currency note issue with that of the Bank took place, will be seen from the following table—

Issue of Notes authorized—			
By the Bank Charter Act, 1844		.	£14,000,000
By Order in Council of	Dec 7, 1855	.	475,000
,, ,,	July 10, 1861	.	175,000
,, ,,	Feb. 21, 1866	.	350,000
,, ,,	April 1, 1881	.	750,000
,, ,,	Sept. 15, 1887	.	450,000
,, ,,	Feb 8, 1890	.	250,000
,, ,,	Jan. 29, 1894	.	350,000
,, ,,	Mar 3, 1900	.	975,000
,, ,,	Aug 11, 1902	.	400,000
,, ,,	Aug. 10, 1903	.	275,000
,, ,,	Feb 13, 1923		1,300,000
			£19,750,000

"Gold Coin and Bullion."

We now come to the third item on the Credit side of the Account—"Gold Coin and Bullion, £161,214,085"—which represented the gold cover for all notes issued by the Bank in excess of the Fiduciary portion of its issue. For every £5 note issued in excess of £19,750,000 standard gold, equivalent to 616 37239 grains (i e. the standard weight of the £5 gold piece laid down by the Coinage Act), must be deposited in the vaults of the Bank of England. It follows, then, that the amount under "Gold Coin and Bullion" automatically rises or falls with the increase or decrease in the total of the notes put forth by the Issue Department. It is in this respect that the Bank of England has been described as a bank of deposit, which takes charge of gold for the public, issues a transferable receipt there against, and gives the gold out again as soon as the receipt is returned and cancelled [1]

"Silver Bullion."

The next item, "Silver Bullion," is merely reminiscent of the first passing of the Bank Charter Act of 1844. As a matter of fact, no silver bullion is held against the notes,

[1] Clare in *Money Market Primer* (p. 16).

though the Bank is empowered under Section III of the Act to retain in its Issue Department an amount of silver bullion not exceeding one-fourth part of the gold coin and bullion there held. Since silver is not legal tender in payment of a Bank of England note, the provision is comparatively useless; and, in view of the constantly fluctuating price of silver bullion, it is probably just as well that the Bank refrains from holding the full proportion of silver in the cover for its notes.

11777

"Proprietors' Capital."

It is in the figures given in the account of the Banking Department that the money market is most interested. The first item that strikes the eye is that on the Liabilities side—"Proprietors' Capital, £14,553,000."

On the face of it, this item is simple enough; it is the total amount of stock held by those who are fortunate enough to have shares in the institution which is the corner stone of British banking. But let anyone endeavour to trace out exactly how and by what means the capital has reached its present figure; he will find his task somewhat baffling. The original capital, as we have shown on page 36, was raised by public subscription, the entire amount of which was lent to the Government. That was in 1694, the sum being £1,200,000. In a word, this loan was made by the Bank to William III's Government in return for the granting of the Charter which authorized the Bank to start business. It was not a very auspicious beginning for so great and dignified a body as the "Governor and Company of the Bank of England," yet the early history of the subsequent additions to the Bank's capital abounds with similar examples. It is one long story of loans to impecunious kings, of financial assistance to successive Chancellors of the Exchequer who have been hard put to it to find the money for carrying on the government of the country and empire, and of advances to Government to enable it to tide over times of stress and crisis.

The first renewal of the Bank's Charter was in 1697; a condition precedent to that renewal was the agreement by the Bank to make a loan to the Government. The first amount asked for was £2,500,000; but to this the Bank demurred, and finally it was allowed to add £1,001,171 to its capital under certain conditions which were embodied in the Act of 3rd February, 1697. The next accretion was on February 22, 1709, when in return for various concessions to the Government, to wit, a loan of £400,000 and an advance subscription of £1,775,027 for Exchequer Bills which the Treasury wished to be issued to the public, the Charter of the Bank was extended for another twenty-one years from August 1, 1711, and its capital raised to £6,577,370. In 1720, the capital was once more increased to £8,959,955, mainly for the purpose of helping the Government to clear up the mess into which it had got as the result of the "South Sea Bubble." In 1742, the renewal of the Bank's Charter was again coincident with a loan of £1,600,000 from the Bank to the Government, and this necessitated a further call on the shareholders and an increase in the capital to £9,800,000.

The cost of rendering the Government assistance to drive out the Pretender was responsible for another increase in the capital, in 1745, to £10,780,400.

The Charter was again renewed in 1764 and in 1782, and each time, as a sort of *quid pro quo*, the Government exacted a loan, or induced the Bank to negotiate the purchase of Exchequer Bills or to make advances. The usual calls were made on stockholders, and the capital was still further increased to £11,642,000.

Between 1782 and 1812 various repayments and adjustments appear to have been made by the Government in its debt to the Bank, and these had the effect of reducing the Proprietors' Capital to a round amount of £11,000,000. Calls on the shareholders, however, had to be made from time to time in succeeding years until, in 1833, we find the capital once more standing at £14,520,000 But the

Government in that year repaid to the Bank advances amounting to £3,630,000, thus reducing the capital to £10,890,000, from which level it was raised by gradual instalments until, in 1844, when the famous Bank Charter Act was passed, we find the capital had reached £14,553,000 There has been no alteration in the item "Proprietors' Capital" since the passing of the Bank Charter Act of July 19, 1844, and, as will be seen from the copy of the Bank Return on page 57, it still stands at £14,553,000 So much for the Capital.

"Rest."

The next item on the Liabilities side of the Banking Department Account is the "Rest," which corresponds to the Reserve of any other bank. This, the reader will observe, stood on November 21, 1928, at £3,204,147 The "Rest" is never allowed to fall below £3,000,000, and, although no profit and loss account or balance sheet, other than the Bank Return, is ever issued, it is common knowledge that any surplus over £3,000,000 in the "Rest" is the amount available for dividends to stockholders. In the early part of its career the Bank of England did not attempt to build up any reserve fund; what profits there were, were usually divided among the shareholders. But experience soon demonstrated the need in times of stress for a better second line of defence than the usual call upon shareholders, so, in 1722, the directors of the Bank wisely decided to build up a Reserve Fund to meet emergencies. The "Rest" must not be confused with the Reserve represented by the total of the notes and gold and silver coin in the Banking Department, to which we shall presently refer.

"Public Deposits."

The third item on the Liabilities side is that of "Public Deposits," £14,898,189, which, as the account plainly shows, is simply the heading under which is shown Government

funds held by the Bank. It consists of the balances of the Exchequer, Savings Banks, Commissioner of National Debt, and other dividend accounts. It is no exaggeration to say that the "Public Deposits" item is one of the most important in the Bank Return, and the movements in the total are closely watched by the money market. "Public Deposits" are at their highest point at the end of the March quarter. As a matter of fact, there is usually a steady increase from Christmas until March, resulting from the ingathering of income tax and land tax. Now that income tax is payable in two instalments, there is also a noticeable increase from July to August. All receipts by the Government tax collectors are paid into the Bank of England. The influx of these funds from January to March comes at a convenient time, since on January 1, large interest payments on Consols, War Loan issues, etc., have the effect of reducing very considerably the Government's balances. The close of the Government's financial year is on March 31, and immediately prior to this it is the practice of the Treasury and other Government departments to clear up all their large payments due. The effect upon "Public Deposits," which in the meantime have recovered from the heavy inroads made into them by the encashment of Government dividends, is very soon apparent. In the first week of April "Public Deposits" again fall They remain on the low side until July, when, as we have said, payments for the second instalment of income tax are made

"Other Deposits."

We shall refer at a later stage to the effects on the money market of these transfers of money to the public and re-transfers to the Government. For the moment we must turn to the fourth balance on the Liabilities side —"Other Deposits," £99,472,105. This large sum represents the total of the balances of the Bank's private customers; in effect, it corresponds to the current account

balances of the other joint stock banks; but the proportion of money belonging to ordinary customers is comparatively small, for the "Other Deposits" include the balances of many of the other banks in the country which have accounts with the premier institution. This item also includes balances of various Government bodies, such as the India Council, etc. For instance, each of the clearing banks is obliged to keep an account with the Bank of England; and, as a matter of convenience, most of the banks outside the "clearing," including the London offices of the colonial banks, also make it a practice to maintain a satisfactory balance with the Bank of England. In fact, this item represents the balances of nearly the whole of the banks of the country, consequently its intimate connection with the London Money Market will necessitate a detailed explanation in a later chapter.

"Seven-day and Other Bills."

The last item on the Liabilities side of the account—"Seven-day and Other Bills, £2,591"—is now a thing of the past. It refers to a form of bill of exchange that was rapidly becoming obsolete at the date of the Return and the Bank of England was the only London bank that continued to issue such bills. They were not payable on demand, but were usually drawn at seven days' sight They required acceptance and took no days of grace. One writer declares that the issue of bank post bills in 1855 was an approved mode of doing business, and the use of them was most beneficial in banking practice. The Bank of England at that time had been using them for at least a century [1]

Bank post bills appear to have originated about 1738 At that time it was not an infrequent occurrence for highway robbers to stop the mail coaches and relieve them of their contents; so, in response to urgent appeals, the

[1] *Cf.* Tillyard, *Banking and Negotiable Instruments* (3rd Ed, p. 205 *et seq.*).

Bank of England notified the public that it would issue "bills payable at seven days' sight, so that in the case of the mails being robbed the proprietor might have time to give notice thereof." The bills were issued in amounts varying from £10 to £1,000. They were in the form of promissory notes payable seven days after sight to a specified person or to order. The Bank of England discontinued their issue from September 1, 1934.

"Government Securities."

We now come to the Assets side of the account issued by the Banking Department, which comprises four items: "Government Securities," "Other Securities," "Notes," and "Gold and Silver Coin."

The first, "Government Securities—£48,340,327," includes investment securities of the British Government, plus Ways and Means Advances to the Government, and Deficiency Advances, the last two items forming a convenient cloak under which are hidden the overdrafts allowed by the Bank of England to the Government on the security of incoming or anticipated revenue.

"Other Securities."

"Other Securities—£34,757,491," include a variety of investment securities held by the Bank on its own account. The Bank does not publish a list of its holdings under this head, but they are understood to include advances to bill brokers and ordinary customers, bills discounted for either parties, and any other facilities granted.

"Notes" and "Gold and Silver Coin."

"Notes—£48,161,710," and the following item, "Gold and Silver Coin—£870,504," constitute the really vital items of the complete return. They represent the Reserve, the ratio of which to the Deposits found on the other side of the account forms such a prolific source of "copy" each week for the enterprising City journalists. This

Reserve, as Clare points out, is not only the basis of the Bank's credit, it is also the key to the Bank Rate, consequently, the fluctuations in it are watched most carefully by all sections of the money market. The ratio it bore to Deposits on the day the Return was made up (21st Nov., 1928) was 42·87 per cent.

The ordinary reader of the money article is often puzzled as to the precise figures from which the "Ratio" is calculated, so we make no apology for concluding this inordinately long chapter with an example of the calculation based on the Return for November 21, 1928.

It will be observed that in the Banking Department Account the

Public Deposits amount to .	. £ 14,898,189, and the
Other Deposits to . .	. £ 99,472,105
Making total Deposits . .	. £114,370,294

On the other side of the account—

Notes are given as . .	. £48,161,710
Gold and Silver Coin . .	. 870,504
	£49,032,214

The latter total forms the Reserve, and the ratio which it bears to total Deposits can, therefore, be expressed by the fraction—

$$\frac{\text{Reserve} \times 100}{\text{Deposits}} = \frac{£49{,}032{,}214 \times 100}{£114{,}370{,}294} = 42\cdot87\%$$

CHAPTER IV

THE AMALGAMATION OF THE BRITISH GOVERNMENT'S TREASURY NOTES ISSUE WITH THAT OF THE BANK OF ENGLAND—HOW IT WAS ACCOMPLISHED—THE NEW BANK RETURN ANALYSED—THE FIDUCIARY ISSUE AND THE EFFECTIVE BANK NOTE RETURN

WE now come to another landmark in the history of the note issues of the United Kingdom—the amalgamation of Government's currency note issue with the note issue of the Bank of England. As a precursor to that momentous step, there was issued the Currency and Bank Notes Act, 1928 (18 & 19 Geo. 5, c. 13). This Act received Royal Assent on July 2, 1928, and came into force on November 22, 1928 For purposes of reference, the Act is printed in full as an appendix to this book, together with the Gold Standard Act.

Section 10 of the Currency and Bank Notes Act is the one that covers all Returns of the Bank of England issued after November 22, 1928; it is a simple statement of fact, and reads—

> "The form prescribed by Schedule A to the Bank Charter Act, 1844, for the account to be issued weekly by the Bank under section six of that Act may be modified to such an extent as the Treasury, with the concurrence of the Bank, consider necessary, having regard to the provisions of this Act."

The required alterations in form were made in the first Bank Return to be issued subsequent to the amalgamation of the note issues, that for the week ended November 28, 1928, of which a facsimile is shown on page 57.

The amalgamation of the British Treasury notes issue with that of the Bank of England was of great historical

COPY.]

BANK OF ENGLAND

AN ACCOUNT for the Week ended on Wednesday the 28th day of November, 1928.

ISSUE DEPARTMENT

	£		£
Notes Issued—		Government Debt	11 015 100
In Circulation .	367 001 148	Other Government Securities .	233 568 550
In Banking Department .	52 087 797	Other Securities	10 176 193
		Silver Coin . .	5 240 157
		Amount of Fiduciary Issue .	£260 000 000
		Gold Coin and Bullion. . .	159 088 945
	£419 088 945		£419 088 945

Dated the 29th day of November, 1928.

C. P MAHON, *Chief Cashier.*

BANKING DEPARTMENT

	£		£
Proprietors' Capital	14 553 000	Govt Securities .	52 180 327
Rest . . .	3 254 001	Other Securities	
Public Deposits—(including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts) .	21 452 051	Discounts and Advances. £13 586 293	
Other Deposits—		Securities £20 214 855	33 801 148
Bankers. £62 379 409		Notes . .	52 087 797
Other Accounts £37 185 203	99 564 612	Gold & Silver Coin	757 041
7 Day & Other Bills	2 649		
	£138 826 313		£138 826 313

Dated the 29th day of November, 1928.

C. P. MAHON, *Chief Cashier.*

importance, and it is interesting to examine how the transition was accomplished.

The Currency and Bank Notes Act, 1928, came into force on November 22, 1928, and on that date the new Bank of England notes for £1 and 10s. were put into circulation. The transfer of the Treasury's Issue to the Bank of England was skilfully accomplished, and even the keenest critics could discover no hiatus. Further, apart from the smooth working of the technical changes involved by the transfer, the London Money Market was agreeably surprised to find that the Bank of England had taken a commendable step forward by making its weekly Return under the new conditions more intelligible.

From a comparison of the Returns of November 21 and 28, 1928, the reader will observe the alterations. "Other Deposits" in the Banking Department figures are now divided into "Bankers' Deposits," which include the cash balances of all the London Clearing banks, the other English joint-stock and private banks, and the Scottish and Northern Irish Banks, and "Other Accounts," the bulk of which are mainly comprised of deposits of private customers, such as the large industrial firms which keep accounts with the Bank of England. In commenting on this splitting up of the somewhat ambiguous item "Bankers," the Midland Bank, Ltd, in its circular of December, 1928, says—

"When inquiry is made as to the composition of the similar item in the Parliamentary papers issued up to 1878, an interesting sidelight is thrown on the changes which have occurred in the organization of British banking since that time. The item in the Old Return appears to have covered the balances of the London Clearing Banks and bankers only, so that they were incomplete in their measurement of the quantity of bank reserves maintained in the form of balances with the Bank of England. Since that time the private banker has almost disappeared, and the business has become so highly concentrated that to-day's figures of bankers' balances, so much larger than in 1877, are by their very inclusiveness quite incomparable

with the older statistics. At the same time, even the figures up to 1877 were not strictly comparable, for it was only in the early 'fifties that the joint-stock banks were admitted to the London Clearing House."

However, the significance of the new item "Bankers' Deposits" is that it will henceforth form a valuable key to the amount of actual cash available in the London Money Market, and, to paraphrase the remarks on the subject made in the Midland Bank's circular, with a little practice it may in future be possible to gain important information on short-term credit conditions. The example given by the Midland Bank is that class of problem involving fairly precise knowledge of the amount and changes in the quantity of currency in the hands of the public, exclusive of the banks. Formerly, no one could state with any degree of accuracy how much currency was held by the banks in their own treasuries. But, henceforth, a fairly close estimate may be made by comparing the figures given in the Bank of England Return with those published by the banks. However, as the Midland Bank also points out, in making this deduction, it must be borne in mind that the London Clearing Banks do not make up their weekly returns on the same day as the Bank of England, and, in any case, the monthly statements published by the banks are merely averages of the weekly returns. Another point is that the "bankers' balances" shown by the Bank of England in its Return, include the balances of other banks not in the London Clearing. Nevertheless, on the facts given, we have sufficient data to base an estimate of the paper currency outside the banks

The importance of the sub-division of "Other Deposits" is emphasized when we realize that, for the first time in the Bank's history, it is made possible for those interested to follow closely the development of three separate sides of the Bank's business.

The Public Deposits indicate the operations of the Old Lady of Threadneedle Street in her role of banker to the

Government and the other related bodies indicated under this heading in the Return. The variations in Bankers' balances will reflect more or less clearly the operations resulting from the Bank of England's position as the central institution.

The item "Other Accounts" will give an indication of the Bank's private business. Included in the figures under this head, however, are amounts relating to two distinct parts of the Bank's business, "its ordinary banking operations, similar to those of any non-central bank, as well as transactions arising from its international relationships."[1] Of the relative scope and importance of these two branches of the Bank's affairs, the public will get no more enlightenment in future than it has done in the past, though this does not detract from the value of the sub-division in the Return. However, if the Bank continues its policy of retrenching its private business, as it has done by disposing of its West End branch to another bank (the Royal Bank of Scotland), "Other Accounts" may in time relate practically to its operations as a Central Bank.

To turn to the other side of the account, it will be seen that "Other Securities" are now sub-divided into "Discounts and Advances" and "Securities." This innovation will permit of a more exact estimate of the London Money Market's borrowings from the Bank of England week by week, though, in the absence of any official statement as to what the assets really represent, there is some difference of opinion in the money market as to their exact significance. The *Economist*, in its comments on the subject, states—

> "The important distinction between 'discounts and advances' and 'securities' is this: When a bill is discounted at the Bank on the market's initiative, the Bank will rank it as a 'discount.' When the Bank buys bills on its own initiative as part of its open-market policy, it will rank as a 'security'—'Government,' for Treasury Bills, and 'Other,' for commercial bills."

[1] *Cf* Midland Bank circular, December, 1928—January, 1929.

Other experts hold the opinion that a bill discounted, whether a Treasury or other bill, will be included under the heading "Discounts and Advances." If this view be accepted, then the value of the figures in the study of money market conditions and monetary policy, says the Midland Bank, will at once become apparent.

The Midland Bank illustrated the point by showing what might happen in the Return when different hypothetical transactions take place, and their remarks are so apposite that we give them in full—

"Suppose conditions become stringent in the money market, which is forced to resort to the Bank for additional cash supplies. Then either Treasury or other bills may be discounted, or money may be borrowed. In any case of this kind, it seems, the amount discounted or borrowed will appear under 'discounts and advances.' But suppose the Bank sees fit on its own initiative to give a basis for credit expansion, whether as a temporary measure or as a permanent addition to money supplies to finance a growing volume of business, then it can adopt several methods of procedure, all having the same result. It can, in the first place, buy long-term securities. If it buys Government securities the addition to its assets will appear under that head, if non-governmental, then the addition will fall under the 'securities' section of Other securities. It may, however, buy bills. If it buys Treasury bills the new assets will presumably appear as Government securities. If it buys bank bills, however, it is not clear whether the addition to its assets will fall under the head of the 'discounts and advances' or the 'securities' sub-division of Other securities The figures, therefore, are not quite as simple as might at first sight appear. It is by no means certain that market initiative must always be regarded as the proximate cause of changes in 'discounts and advances,' though it does seem probable that Bank initiative is to be regarded as the source of all combined variations in Government securities and 'securities.' Until this question of doubt is disposed of no clearly defined and simple content of the figures can be unequivocally accepted. Here again experience is required before these undoubtedly useful statistics can be interpreted with any high degree of confidence."

There remains to be discussed the Issue Department figures given in the Return of November 28, 1928. These are of importance as showing the transfer of the Government's Note Issue to the Bank. As will be seen by reference to the Return on page 57, the amount of the Fiduciary Issue was then £260,000,000, and when the transfer was made cover for this amount had to be forthcoming. (*Vide* Section III—Currency and Bank Notes Act, 1928.) It was built up in this manner

The Treasury transferred to the Bank of England from the Currency Notes Redemption Account—

Securities and Silver		£229,499,497
The Bank of England already held securities against its fiduciary issue—		
Government Debt	£11,015,100	
Other Securities	8,734,900	£19,750,000
The Bank of England purchased outright from the Treasury, securities for £12,151,630 Of this amount they transferred to the Issue Department, securities to the value of		£10,750,503
This makes up the amonnt of the cover for the Fiduciary Issue of		£260,000,000
Then, from a comparison of the Returns of November 21 and November 23, 1923, it will be observed that the holding of Gold was £2,125 140 less, and stood on the latter date at		£159,088,945
Total		£419,088,945

Now if the reader will turn to the other side of the account of the Issue Department he will observe that against this sum—

Notes put into circulation amounted to	£367,001,148
Notes in the Banking Department amounted to	52,087,797
	£419,088,945

Effective Bank Note Circulation.

To complete our examination, it will be of interest to show the position of the Effective Bank Note Circulation before and after the amalgamation of the Note Issues.

The Bank of England's Note circulation, according to the

Bank's Return of November 21, 1928, was £180,964,085, from which has to be deducted £48,161,710 of notes then held by the Banking Department, thus leaving £132,802,375 Of this amount, £56,250,000 was held as part backing for the Treasury Note Issue, thus leaving the Effective Bank Note Circulation on that date at £76,552,375.

When the transfer took place, to the latter sum had to be added the amount of the Government's Currency Notes outstanding, £285,504,130, making the total note circulation of the country on November 21, 1928, £362,056,505 For comparative purposes, then, this is the figure which has to be taken with the Note Circulation shown in the Bank Return of November 28, 1928, £367,001,148, from which we find that there was an actual increase in the Effective Note Circulation of £4,944,643 between November 21 and November 28, 1928.

The New Fiduciary Issue.

There remains to be explained how the sum of £260,000,000 was arrived at as the Fiduciary Issue of the Bank of England under the new conditions The fixing of this limit was no mere accident, it was the subject of careful calculation. On the recommendation of the Cunliffe Committee on Currency and Exchange, the Treasury had fixed the actual maximum of 1927 as the permitted maximum fiduciary issue of Currency Notes for 1928. This was £244,940,000. The Bank of England's fiduciary issue, as we have already stated, was £19,750,000, so the two were added together, making a total of £264,690,000 But then there had to be taken into account British Currency notes circulating in the Irish Free State. these were in course of being replaced by the Irish Free State's own notes, and the amount outstanding was estimated at £6,000,000 This was deducted from the total of £264,690,000, reducing it to £258,690,000, and this last total was rounded up to make the £260,000,000 now fixed as the amount of the new Fiduciary Issue of the Bank of England.

It remains to be added that Section II of the Currency and Bank Notes Act, 1928, gives the Treasury power at the request of the Bank of England, to reduce the Fiduciary Issue, while Section VIII of the Act makes provision for an increase in the Fiduciary Issue, with the reservation that any minute of the Treasury authorizing such an increase shall be laid before both Houses of Parliament forthwith. Under this section application was made to the Treasury and the necessary sanction obtained for an increase of the Fiduciary Issue to £275,000,000 as from August 1, 1931,

The reason for the increase of £15,000,000 was the very large gold withdrawals that had taken place, and these, coinciding with the usual holiday season note expansion, threatened to reduce the Reserve to an abnormally low level.

There was no further alteration in the Fiduciary Issue until March 31, 1933, when, following an inflow of over £50,000,000 gold to the Bank of England in the first quarter of the year, the total was reduced to the former level of £260,000,000 Then, some three years later, on December 15, 1936, the Bank of England announced the purchase of £65,000,313 of bar gold. This was by far the largest daily movement of gold ever recorded. The gold was not purchased on the open market, but was transferred to the Bank from the accumulated stock of gold held in the British Government's Exchange Equalization Account.

The normal effects of this transaction were practically neutralized by a reduction of £60,000,000 in the Fiduciary Issue, thus bringing it down to £200,000,000. Needless to say, such a large transaction did not pass unnoticed in political circles, and in reply to a question in the House of Commons, the Chancellor of the Exchequer stated that it had been decided to increase the amount of gold held by the Issue Department of the Bank of England by £65,000,000. As such a step by itself would have meant a very sharp expansion of the credit base, for which there was no justification at the time, it was decided at the request of the

Bank of England to reduce the Fiduciary Issue by £60,000,000, the net addition to the total note reserve being therefore £5,000,000. It was emphasized that the measure was temporary, and it was pointed out that the Fiduciary Issue may be increased or diminished at any time in the future in accordance with the provisions of the Currency and Bank Notes Act of 1928.

The next movement took place on November 16, 1937, when at the request of the Bank of England the Treasury authorized an increase of £20,000,000 to £220,000,000 in the Fiduciary Issue. For some time it had been evident that the note issue would reach a new peak figure before Christmas, 1937, and that the seasonal pressure would necessitate measures to strengthen the Reserve in the Bank of England. This increase is merely a temporary one, and is noteworthy as being the first occasion that the amount of the Fiduciary Note Issue has been varied to meet a temporary need. It makes the fourth change that has been made since the passing of the Currency and Bank Notes Act in 1928, and as one of the banks said in a market circular at the time, in these days when countries are liable to take fright concerning the stability of their own currencies and to seek safety abroad for their funds, there is much to be said in favour of elasticity in the total of the Fiduciary Issue. Vagrant gold balances, and the hoarding of Bank of England notes, indeed, make that elasticity essential, if our monetary policy is to be wisely guided by general considerations rather than artificial and arbitrary limitations.

The Reserve.

The Reserve, as was explained in our previous chapter, is comprised of the items Notes and Gold and Silver Coin: the former in the Return of November 28, 1928, stood at £52,087,797, and the latter at £757,041, making a total of £52,844,838, and it is the ratio which the total of Notes and Gold and Silver Coin bears to the total of Public Deposits and Other Deposits on the Debit side of the Banking

Department Account, that will continue to be as carefully watched in future Returns as it has been in the past. The total in the Return of November 28, 1928, of these Deposits (Bankers' and Other Accounts) it will be noticed was £121,016,663, and by a calculation similar to that by which we concluded our last chapter, we find the ratio to be—

$$\frac{£52,844,838 \times 100}{£121,016,663} = 43.6\ \%$$

Profit on the Note Issue.

There remains to be mentioned the subject of profit on the Note Issue. Prior to the amalgamation of note issues, the Bank made a profit on its note circulation, though this was much smaller than was generally known. It averaged about 3 per cent per annum, but was considerably reduced by the heavy working expenses, and the £180,000 per annum payable by the Bank to the Government under Section VIII of the Bank Charter Act of 1844. However, the whole question of profit on the amalgamated note issues was dealt with in the Currency and Bank Notes Act, 1928, and any profit now made is payable to the Government.

Section VI of that Act provides that—

"(1) The Bank shall, at such times and in such manner as may be agreed between the Treasury and the Bank, pay to the Treasury an amount equal to the profits arising in respect of each year in the Issue Department, including the amount of any bank notes written off under Section VI of the Bank Act, 1892, as amended by this Act, but less the amount of any bank notes so written off which have been presented for payment during the year and the amount of any Currency notes called in but not cancelled before the appointed day which have been so presented.

"(2) For the purposes of this section the amount of the profits arising in any year in the Issue Department shall, subject as aforesaid, be ascertained in such manner as may be agreed between the Bank and the Treasury.

"(3) For the purposes of the Income Tax Acts, any income of, or attributable to, the Issue Department shall be deemed to be income of the Exchequer, and any expenses

of, or attributable to the Issue Department shall be deemed not to be expenses of the Bank.

"(4) The Bank shall cease to be liable to make any payment in consideration of their exemption from stamp on bank notes."

It follows then, that the Government now takes all the ascertained net profits on the note issue, and that the Bank is exempted from its original liability to pay £180,000 per annum.

As a fitting conclusion to this chapter we give, on the following page, the latest Bank Return issued as these lines were written. The Return was published in *The Times* of December 30, 1937, and the explanation of the changes in the various items will serve as a useful guide to the reader who has perused the preceding pages

[COPY.]

BANK OF ENGLAND

AN ACCOUNT for the Week ended on Wednesday, the 29th day of December, 1937

ISSUE DEPARTMENT

	£		£
Notes Issued—		Government Debt	11,015,100
In Circulation	505,317,131	Other Government Securities	208,687,662
In Banking Department	41,089,494	Other Securities	286,818
		Silver Coin	10,420
		Amount of Fiduciary Issue	£220,000,000
		Gold Coin and Bullion	326,406,625
	£546,406,625		£546,406,625

Dated the 30th day of December, 1937

K O PEPPIATT, *Chief Cashier.*

BANKING DEPARTMENT

	£		£
Proprietors Capital	14,553,000	Government Securities	114,558,165
Rest	3,441,563	Other Securities—	
Public Deposits (including Exchequer, Savings Banks Commissioners of National Debt, and Dividend Accounts)	11,384,185	Discounts and Advances £9,205,417	
Other Deposits—		Securities 20,866,663	30,072,080
Bankers £120,640,908		Notes	41,089,494
Other Accounts 36,566,801	157,207,709	Gold and Silver Coin	828,718
	£186,586,457		£186,586,457

Dated the 30th day of December, 1937

K O PEPPIATT, *Chief Cashier.*

As expected the Bank Return made up to December 29 shows an appreciable contraction in the note circulation from the peak figure reached in the previous return The total is £505,317,131, a reduction of £3 998 515, there was a decrease of £70,232 in the coin and bullion, with the result that the net increase in the reserve is £3 928 283 raising its figure to £41,916,212 In spite of the larger reserve the proportion has fallen from 26⅛ to 24⅞ per cent owing to the large expansion in deposit liabilities Bankers' deposits have increased by £22,425,000 and public deposits by £612,000 The cause of the sharp rise in bankers' deposits is to be found in the increase of £18 140,000 in the Government securities, a movement which is to be associated partly with the incidence of Treasury Bill maturities and payments Nearly all the bills allotted at last Friday's tender were for payment to-morrow, and thus there have been no payments to offset the maturities in the first half of the week The official return is given above

CHAPTER V

THE CONSTITUTION OF THE LONDON MONEY MARKET—THE FUNDS EMPLOYED THEREIN

In tbe preceding chapter the Bank of England was described as the centre of the London Money Market, and as such it has, as we have seen, enormous funds at its disposal In the Return we have just examined, the total Deposits alone of the Bank were shown to amount to £168,591,894. Then, as it is the depositary of not only the Government's funds, but also of a good deal of the money of the other hanks, the Bank of England acts as an immense reservoir into which the unemployed monetary balances are constantly pouring, and from which they as constantly flow out when they can be used with advantage. It is not too much to say that the Bank of England is the axle on which the whole wheel of the money market's business turns. The axle, however, is of very little use without the constituent parts of the wheel; each is reliant on the other for its strength The hub of the wheel is represented by the joint stock banks; the spokes hy the other hanks of the country; the rim by the discount houses; and, to make the wheel complete, the boss may be taken to represent the bill brokers, stock brokers, and finance houses, the paint being left to indicate the public, without which one imagines the market could not exist, much less the banks.

Funds of "Big Five."

Now, in the London Money Market, that with which we are principally concerned is the supply of funds, which, to carry our simile still further, is the grease necessary to lubricate the wheel of the money market. What are the

extent of these funds, and whence do they arise? We have seen something of the Bank of England's position and its disposable funds. Next in order of importance as the universal providers of money come eight English clearing banks, the Midland Bank, Ltd., Lloyds Bank, Ltd., the Westminster Bank, Ltd., Barclays Bank, Ltd., the National Provincial Bank, Ltd. (the so-called "Big Five"), the District Bank, Martins, and Williams Deacon's Bank. The funds which these combined institutions control are of great magnitude. On March 31, 1937, according to the *Economist's* statistics—

		£
Their Total	Capital and Reserves were	132,500,000
,, ,,	Cash in Hand .	222,400,000
,, ,,	Call Money .	164,800,000
,, ,,	Deposits .	2,206,600,000

In addition to the clearing banks, cognizance must be taken of the English provincial banks, the private banks, the Scottish and Irish banks, all more or less intimately connected with London, and all having large disposable funds on the London money market.

These, however, do not exhaust the spokes in our wheel: there are the African, the Australian, the Canadian, Indian banks, etc., all with offices in London, and all contributing their quota to the funds with which the Money Market has to deal. There are also the London branches of the foreign banks, but these, like the Colonial banks, tend rather to employ their funds in financing the overseas trade of the country than to utilize them to any extent on the London Money Market. Nevertheless, as they do all bring some money into the great pool, it is as well to note their influence. Finally, we have the great discount houses which play an important role in the Money Market, and have large floating funds constantly employed.

Statistics, of course, are anathema to the man in the street; but in order to give him a bird's-eye view of the disposable funds in the market, we give extracts from the

figures of 40 British banks, for 1936–37, published by the *Stock Exchange Gazette* on May 29, 1937—

	£
Capital—paid up .	120,720,947
Reserves, etc	91,151,356
Deposits, Current Accounts, etc .	3,028,803,832
Undivided Profits	10,361,235
Cash in Hand and at Bank of England	656,958,845
Money at Call and Short Notice	242,121,124

We have taken the various figures as being those of the institutions more directly responsible for the supply of funds to the market. Needless to say, there are others whose connection with the Money Market, if not quite so close, is intimate. Such are the bill brokers, the stock brokers, and finance houses, all of which have at times large resources for employment on the market, and all of them are closely identified with the operations that take place there from day to day. Of their business we shall speak later, for the moment, we must confine ourselves to the movements of money between the public, the banks, and the Bank of England.

Liquid Portion of the Funds.

The joint stock banks and discount houses, to which we have referred, constitute what one might call the liquid portion of the London Money Market; and our object in introducing them was to give the reader an idea of the relation of their funds to those appearing in the Bank Return under "Public Deposits" and "Bankers" and "Other Accounts"

We need not, however, pay too much attention to the balances of the discount houses, since in actual practice most of the money they lend on the market represents cash previously borrowed from the banks.

The question at once arises, whence do the banks themselves get the huge supplies of money which we find under the heading of Cash and Deposits in their balance sheets?

It is often stated (crudely, as we think) that the money is received from customers who pay it into their current accounts from day to day, or place it on deposit at varying rates of interest for long or short periods. The banker, we are told, is a person who takes care of other people's money and lets them have it back on demand as and when required—always supposing there is nothing in the shape of a moratorium or anything of that sort to prevent his paying out freely the moneys he has previously received. In the early days, those who laid claim to the title of "banker" merely issued what were in effect bank notes to their depositors; later, the term "banking" came to include not only the issue of bank notes to depositors, but also to borrowers against security. At a still later period, "banking" included the issue of bank notes as required, and the acceptance of deposits withdrawable by cheque on demand. Finally, we get to the point when the banks of issue have disappeared, and in their place we have the great deposit banks—institutions that merely accept deposits and allow them to be withdrawn on demand by cheque. This is the main business of the banks; and, though they undertake many other operations, it is beyond the scope of this book to trace in detail the banking system as it is to-day. All we shall attempt to do is to refer to the banks' operations in so far as they affect the money market.

Increase in Bank Deposits.

Well, to return to the deposits representing money paid into the banks by customers. In 1833, the deposits of all the British joint stock banks publishing accounts amounted to £399,485,000 only, in the year 1931–32 they reached the enormous total of £2,419,532,000. Not all of a banker's deposit money can be used at any one time on the market. A certain proportion the banker has to keep in readiness to meet cash demands; this is known as "reserve money." Of the remainder, he will lend part to

those who represent the open market—the bill brokers, stock brokers, and the like, utilize a certain amount in advances to clients; make more or less permanent investments in gilt-edged securities; he will also invest a proportion in first-class bills of exchange, maturing at short intervals, and the balance he will pay into his account at the Bank of England. The cheques paid and received during any one day are set off the one against the other in the Bankers' Clearing House; and as each of the clearing banks keeps an account at the Bank of England, the difference in their daily clearings are settled by transfers from one account to the other in the Bank of England's books. The balances standing to the credit of the clearing and other banks' accounts in the books of the Bank of England, plus the difference between the debit and credit balances in the accounts of the Bank of England's other customers at the close of business each Wednesday afternoon, represent the total we see under the heading of "Bankers' Deposits" in the Return.

Let us take one of the dividend periods in order to see the connection between the other banks and the Bank of England.

On June 1, 1929, War Loan interest amounting to some £50,000,000 was paid. The interest warrants received the next day by Tom, Dick, and Harry we may assume were promptly paid into their accounts at one or other of the joint stock banks, and in such circumstances these banks very soon find that they have more money than they can use profitably on the market After utilizing a proportion in the manner we have previously indicated, the joint stock banks have no other alternative but to pay the balances into their own accounts at the Bank of England, and as a result of the combined operations we soon perceive the following movements in money. The " Public Deposits " at the Bank of England, in which are included the Treasury and other Government department's balances, fall, while " Other Deposits," which include the bankers'

balances, rise; and this is plainly revealed if we glance at the figures. At the beginning of June, 1929, "Public Deposits" fell from about £24,341,000 to £8,511,000, while "Bankers' Deposits" and "Other Deposits" rose from £91,618,000 to £106,292,000

The movements, of course, are not exact, or even in the same ratio, for the very obvious reason that all the money for the dividend payments does not come from the "Public Deposits"; if the Government balances are insufficient, the void of course is filled by resort to Ways and Means Advances, or from advances on Deficiency Bills. However, the movement is sufficiently close to illustrate the connection between the various factors. Now that the 5 per cent War Loan has been converted into a 3½ per cent Loan, similar factors may naturally be brought into play, and the reader may find it a useful variation from working out crossword puzzles to try for himself to unravel similar sets of figures

Variations in Public Deposits.

It is a little difficult to set out in detail the exact variations that take place in "Public Deposits," because one is not in a position to state the actual balance at the credit of "Public Deposits" before the dividends are paid. The present form of the Bank of England Return, which now indicates separately the Bankers' Deposits and Other Accounts, does, of course, give a clearer idea of the position than was formerly the case. However, an example given in the Report of the Commission on Currency and Foreign Exchanges gives a direct clue to the manipulation that is necessary, and a study of it will make the position clearer.

The Committee in question took as an illustration the case of the Government's needing funds in excess of the amounts raised by taxation, and they showed that the action of the Bank of England in lending the Government

on Ways and Means advances had resulted in increasing the "Other Deposits" from £56,000,000 in July, 1914, to £171,870,000 in August, 1918 Just how the operations worked out may be traced step by step. Suppose in a given week the Government require £10,000,000 over and above the receipts from taxes paid by the public. They apply to the Bank of England for an advance, and the Bank of England by a book entry places the amount required to the credit of "Public Deposits," much in the same way as a banker credits the account of a customer when he grants him temporary accommodation in the shape of a loan against securities. The security in the Government's case is incoming or anticipated revenue, or Deficiency Bills. Having obtained these advances, the Government then proceeds to pay the money out to its creditors, whether they be annuitants, those to whom war loan dividends are due, or Government contractors. The cheques for these payments the receivers ultimately pay into their own banking accounts and, when the cheques are cleared, the sums are passed to the credit of their bankers, say, the joint stock banks, in the books of the Bank of England. In other words, the sum which the Bank of England has advanced to the Government is transferred from "Public" to "Other Deposits." Finally, the effect of the whole transaction, or series of transactions, is to increase by £10,000,000 the purchasing power in the hands of the customers of the banks, for their deposits with the banks have been increased by that amount Further, the joint stock bankers' cash balances at the Bank of England have been increased by the same sum. Alternatively, currency notes may possibly go into circulation For instance, take a very simple case that frequently occurred during the Great European War, and may happen again. The Government, expecting to have large calls on it, obtains an advance, say, of £10,000,000, from the Bank of England. Cheques are perhaps tendered to a contractor —he wants, however, currency notes to pay his workmen

and asks the Government to give him money in that form. The Government does so—its credit then is left intact at the Bank of England and the notes go into circulation instead—and thus we get an increase in both lots of deposits.

Bankers' Advances.

The Currency Committee traced the operation a step further. They showed that the bankers' liabilities to their customers, having been increased by £10,000,000 and their cash reserves by an equal amount, their proportion of cash to liabilities (which in pre-war days was normally somewhat under 20 per cent) has been improved, and the result is that they are in a position to make advances to their customers, or to the money market, of an amount equal to four or five times the sum added to their cash reserves.

The old goldsmith bankers in their time were fully alive to the possibility of working on a comparatively small reserve of cash. Their experience taught them that a banker can usually make advances a good deal in excess of his cash reserves. The reason is that, generally speaking, only a small percentage of the money entrusted to bankers is required at a given time. Consequently the maintenance of a percentage reserve of cash is sufficient, while a banker's credit is good, to entitle him to promise to pay on demand much larger sums than he actually has available in cash For example, suppose the banker is entrusted with the custody of £100,000. he knows that if he keeps, say, £15,000 in cash, that is, 15 per cent, this will be sufficient in the ordinary way to satisfy current demands, because while some clients draw cheques on their balances, others will be depositing their money with him. This being so, he has a surplus which he can utilize on the London Money Market and, as he receives a higher rate of interest on his loans than he gives on the money deposited with him, he stands to make a considerable profit. In the absence of demand for accommodation either from the open market

or from the bank's own private customers, the banks can increase their investments by the difference between the cash received and the proportion they require to hold against an increase in their deposit liabilities. In fact, during the war, and after, it is this latter procedure which, in the main, has been followed by the banks. They have used their surplus cash to subscribe for Treasury Bills and for short term Government securities. The money thus coming into the Government's hands has again been disbursed by the Government and again returned in the manner we have indicated to the bankers' cash balances, and so it goes on, the process being repeated again and again until each £10,000,000 originally advanced by the Bank of England has created new deposits, representing new purchasing power of several times that amount.

To the casual reader it will, therefore, appear that in some indefinable way there is a connection between "Public Deposits," "Other Deposits," and the creation of credit. Consequently, in order that he may not spend too many sleepless nights in trying to solve the problem, at the risk of some iteration, we will now endeavour to make the position clearer.

Borrower and Lender.

It will not be out of place perhaps if for our solution we refer to a speech made by one of the bankers, the late Sir Edward Holden. In his speech, this banker compared the relative position of borrowers and lenders. If one person lends and another borrows, the one was said to give credit and the other to receive it. It follows, then, that whenever a loan is made, credit is created People frequently speak of bankers being manufacturers of credit as though it was something to be reproached for; others utter the phrase without in the least knowing what it means. The student of economics may understand the

expression quite well, but the words are not quite so clear to the man in the street, so we may be pardoned if we enter into a lengthy explanation.

The point is, that when one pays money into a bank he is credited with the sum so paid in, but the money received by the banker goes into his reserves and thus forms the basis for increased credit. On the other hand, if a person draws money out of the bank he reduces the basis for the credit. Though it should be noted that money paid into the Bank of England has a far greater effect than that paid into any other bank.

If we eliminate these two transactions, that is the payment in and the withdrawal of cash, then practically all loan transactions undertaken by the banks result in the creation of credit. The explanation put forward by Sir Edward Holden was this: We assume that all the banks in the country are combined as one, and that a person borrows from the bank, say, £100,000, but does not withdraw actual cash, then two different transactions take place. In London, the £100,000 would be placed to the credit of the borrower, who would probably proceed to draw out the amount by cheques to pay for purchases, much in the same way as we saw the Government paid its contractors by cheques drawn on the loans made by the Bank of England The cheques drawn by the person who had been granted accommodation by a banker would ultimately be paid in by the sellers of the goods to the credit of their own accounts in the bank. When the whole sum had been withdrawn by the borrower, there would still be the whole of the £100,000 credit outstanding, though possibly the amount would be distributed among the accounts of a number of persons. In banking jargon, it is customary to say of such transactions that the loan has created credit of an equal amount.

The transactions taking place in the provinces were described by the banker mentioned to be rather different. In the circumstances indicated, a customer might be

granted a loan of £100,000; but, instead of having the amount placed direct to his credit, he would commence to draw cheques and continue to do so until he had raised his indebtedness to the agreed amount. In the ultimate result, however, there would be no difference from the London operation, because all cheques drawn would be paid in and go to the credit of the persons receiving them thus the loan would in a similar way create credit.

The position is similar where the banks are working as separate institutions, the loan can be made by one bank and the credit thus created be in one or more other banks; it makes no difference, the loan still creates the credits, and the credits will continue to circulate until the loan is paid off.

How Loans Create Credits.

There remains the question of repayment: this may be effected by the credits created by the loan itself, or through credits created by some other loans—the person repaying may have received cheques from other persons who themselves had raised loans with their bankers

"This making of loans and the creation of credits," said Sir Edward Holden, "might go on continuously were it not for the fact that all the credits are diffused among different people, who pay them to their accounts with their banks on condition of repayment by the banks on demand or at short notice" These two conditions necessitate the banks themselves holding sufficient liquid resources in order to meet the repayment of any credits which are demanded from them

It seems a simple statement to make that loans create credits and that the banks are compelled, by force of circumstances, to hold adequate reserves to protect those credits, yet it is on these principles that the banking systems of the whole world are based

The loans, naturally, are under different forms and

guises; we get many at call and short notice to discount houses, bill brokers, stock brokers, and the like; we have bankers' advances to commerce and industry; bills of exchange discounted to facilitate the overseas trade of the country; investments in Treasury Bills, Treasury Bonds, and long term loans. Then, of the credits created, some are repayable on demand, like the call loans; others at short notice; and yet others at distant periods; yet, on investigation, the ultimate result will be found to be similar.

To prove the truth of these assertions, the banker to whom we have referred called attention to the returns of the Bank of England, the Reichsbank, and the Bank of France, and we may well follow his example.

The Return of one central bank—that of the Bank of England—will perhaps suffice.

The loans made by the Bank of England, whether they be to our own or to foreign governments, or to outside firms, find expression under two headings in the Bank Return —" Government Securities " and " Other Securities "— while the credits created by the Bank also fall under two headings—" Public Deposits " and " Other Deposits." If the Bank makes a loan to the Government, we find at once an increase in " Government Securities "; if to outside firms, the increase is found in " Other Securities." At the same time, we also perceive an increase in " Public Deposits " or " Other Deposits," as the case may be. Similarly, if the loans are paid off and the securities released, there is a decline under one or both of the two headings—" Government Securities " and " Other Securities "—and this again will be coincident with a decrease in " Public Deposits," or " Other Deposits," the only exceptions being when cash is taken out by the loan or paid in by a deposit.

The last Bank Return issued before the war was on July 29, 1914; it revealed the fact that, after allowing for Capital and Reserve, the Loans amounted to £40,268,000; while the Credits, after allowing for cash

credits, were £40,268,000. **In other words, this is the proof that loans create credits.** The figures are not arrived at in an arbitrary manner; we get the result in the following way—

LOANS

		£
Government Securities		11 005,126
Other Securities		47,307,530
		58,312,656
Less Capital	£14,553,000	
,, Rest	3,491,756	
		18 044,756
		£40,267,900

Say, LOANS, £40,268,000

CREDITS

		£
Public Deposits		12,713,217
Other Deposits		54,418,908
Bills		10,960
		£67,143,085
Less Cash Credits, i.e.—		
,, Notes	£25,415,055	
,, Gold and Silver Coin	1,460,139	
		26,875,194
		£40,267,891

Say, CREDITS, £40,268,000.

By way of comparison, and to enable the reader to comprehend the enormous increase in the creation of credits, we add a similar statement based on the Return for November 28, 1928, as shown on page 57. On that date, the LOANS, after allowing for Capital and Reserve, amounted to £68,174,474; while the CREDITS, after allowing for Cash credits, stood at £68,174,474.

Credit Created between 1914-1929.

By deducting the credit created by the Bank, as shown by its Return of July 29, 1914, from that shown in the

		£
The Loans were made up of Government Securities		52,180,327
Other Securities		33,801,148
		£85,981,475
Less Capital	£14,553,000	
" Rest	3,254,001	
		17,807,001
		£68,174,474

		£
Total Credits were made up of Public Deposits		21,452,051
Other Deposits Bankers		62,379,409
" Other Accounts		37,185,203
Bills		2,649
		£121,019,312
Less Cash Credits i.e.—		
Notes	£52,087,797	
Gold and Silver Coin	757,041	
		52,844,838
		£68,174,474

Return of November 28, 1928, we get the actual amount of credit created by the Bank between the two periods—£27,906,583

It is clear that if the central piece of the wheel of the money market has created credit, so must the other banks have been able to do the same It will, therefore, be of interest to glance at the position of the joint stock banks. In October, 1914, the *Economist* published summaries of the June 30 accounts of nineteen of the principal English joint stock banks. The total of their loans of all kinds amounted to approximately £796 millions; and if we deduct from that sum the total of their capital and reserves, say, £76 millions, we get the net loans to the market of £720 millions For credits, we may take the total deposits, approximately £838 millions, from which we deduct the total cash resources of about £118 millions,

and there then remains £720 millions to represent the credits created by the banks.

What was the position on December 31, 1929?

After deducting £142 millions for capital and reserves, the total loans amounted, in round figures, to £885 millions; while net deposits, after deducting cash resources, amounted to about the same figure, £885 millions, thus representing the credits created. In other words, the joint stock banks' loans between 1914 and 1929 had increased by £145 millions, and had created credits to a similar sum.

Movements in "Other Deposits."

In describing the manner in which the Bank of England and the other banks create credit, we have seen how close is the relation between credit and deposits; and we may now proceed a step further and endeavour to follow some of the movements in the "Other Deposits" of the Bank of England and their effect on the money market.

"Other Deposits," as we have already shown, include the credits belonging to other bankers (which represent part of their reserves) and credits belonging to other persons or firms; and, generally speaking, we may consider these deposits to be a rough measure of the supply of loanable capital on the London market. For that reason they are carefully watched by bankers and all whose calling takes them into the market. Any sudden increase over and above the usual weekly average is taken to point to an abundance of funds in the market, and it generally heralds a reduction in the rates charged for accommodation. The mere fact that all the bankers make the Bank of England the custodian of their balances and reserves tends to make the "Other Deposits" a delicate piece of the machinery of the money market; it is sensitive to all influences, and any action which affects the bankers as a

whole is pretty sure to be promptly reflected in "Other Deposits."

As practically all the banks outside the Bank of England maintain balances with the "Old Lady of Threadneedle Street," it is on the premier institution that the brunt of any sudden or long-continued call for funds falls. Similarly, anything which tends to increase the balances in the hands of the outside banks has for effect the filling up of the "reservoir" maintained by the Bank of England.

The periodical fluctuations are well recognized and, beyond the attention given to the matter in the weekly comment on the Bank Return by industrious City editors, the ebb and flow of funds into and from the "Other Deposits" reservoir attracts little attention. It is not the fluctuations which occur with such monotonous regularity week by week, month by month, or quarter by quarter that arouse the reader of the money article from his apathetic indifference; it is the unusual movements of less frequent occurrence which may be said to catch his eye.

Cause of Decline in Other Deposits.

An example of such a movement occurred when the first edition of this book was being written. After a long period of stagnation in the stock markets the public suddenly became seized with the desire to invest idle money in good class securities. A week or two of this investment business tempted the flotation of attractive foreign and colonial government loans, with the not unnatural result that both the genuine investor and the speculator were induced to apply for large wads of the various issues in the hope of making an easy profit. In the circumstances, there was a demand upon the banks for money, and this, coming at a time when the banks were themselves actively employing their accumulated funds by investing in short term Government securities, like Treasury Bills, had an immediate

effect on "Other Deposits." In one week, that ended Feb. 22, 1922, "Other Deposits" declined by over £17½ millions. Incidentally, the heavy demand for the Government's Treasury Bills was itself evidenced by an increase of nearly £13 millions in "Public Deposits." The reader, however, must not be confused with such movements; very simply stated, all that happened was this. The "Other Deposits" decreased mainly because the "Public Deposits" increased In a word, the subscriptions to loans merely transferred the ownership of "Other Deposits."

Reason for Increase in Deposits.

The reverse aspect is seen in times of trade stagnation (and its resultant failures of commercial firms) or of impending crises, and wars or rumours of war We have a useful illustration in the occurrences of July, 1914.

The probability, which soon became a certainty, that the Great Powers would be involved in war temporarily paralysed the exceedingly delicate organization of the London Money Market. Discount business, at first on a small scale, soon came to a standstill, because most banks and finance houses felt acutely the advisability of increasing their stock of money. They called in all loans that they conveniently could. The banks and discount houses, which, as we have shown, are the main element in the money market, deemed it better to rely less upon securities and more upon actual cash. The banks, especially the foreign banks, were therefore obliged to call in loans from the discount houses and brokers. The discount section of the market was thus forced to sell its holdings of bills of exchange having not more than fifteen days to run to the Bank of England and, in addition, they raised loans for a week from the Bank. The strengthening of the monetary position of the banks was revealed by an increase of £12,234,000 in the "Other Deposits" in a week. The effect of the loans by the Bank of England to discount

houses and brokers against the security of short bills was itself shown by a rise of nearly £14,000,000 in "Other Securities."

A better appreciation of the extent to which the banks had strengthened their "Cash in Hand and at the Bank of England" will be obtained by taking a glance at the figures of the Bank of England Returns for the weeks ended July 22, July 29, and August 7, 1914.

In addition to the record of "Other Deposits" during those weeks, we also give the "Other Securities," as the latter item shows that the perfectly legitimate action of the banks in calling in their loans from the discount market, and ceasing to discount further bills, had the effect of forcing the bill brokers and others to resort to the Bank of England for loans, the security for which, obviously, increased the level of "Other Securities"

The figures were—

	Other Deposits	*Other Securities.*
	£	£
July 22, 1914	42,185,297	33,632,762
July 29, 1914	54,418,908	47,307,530
August 7, 1914	56,749,610	65,351,656

It is generally considered that, apart from war and similar crises, periods of dull trade are coincident with a high level of "Other Deposits," and that in such circumstances there is an insufficient outlet for the employment of bankers' balances, and money becomes a drug in the market. The funds accordingly flow into the bankers' bank—the Bank of England—which may or may not utilize them to advantage On mature reflection, and after careful watching of the money market, however, the author is inclined to think that a high level of "Other Deposits" does not necessarily arise from dull trade, although it is certainly coincident with it at times It seems more correct to view the Bank of England's "Other Deposits" as a sort of unemployed reserve, and they are therefore

high if the Bank's commitments are large Although the other banks, temporarily unable to employ the money, do keep it at the Bank of England as a reserve, the Bank itself may be actually employing the money, or, alternatively, keeping it in notes

Effects of Bad Trade.

Owing to the enormous inflation in credit following on the war, these influences have been a little difficult to follow in recent years. Some idea of the effects of stagnant trade, however, may be gathered from the fact that in the middle of the "boom year," 1920, "Other Deposits" stood at £175,966,000; while at the end of November, 1920, when the trade boom had about reached its height, the "Other Deposits" had fallen to £105,314,000: there was a use for money and thus an efflux from the "Other Deposits" reservoir into the more fertile money market. Soon afterwards, a decline in trade began to make itself felt, and towards the end of the year money became, if not superabundant, then in full supply, with the result that on December 29, 1920, "Other Deposits" were up to £175,554,567. The variations in 1921 were of the usual periodic character, but, apart from that, the deposits were maintained at a high level throughout the year, and when trade appeared to have touched the depth of depression at the beginning of December, 1921, they stood at £154,738,656. But, curiously enough in the beginning of September, 1922, with perhaps increased depression of trade, they stood at £111,000,000

Then again, if we take the level of Other Deposits on April 17, 1929, when they stood at £96,796,000, and compare them with the total held on April 16, 1930, we find that over a long period of declining trade there was relatively very little increase, the total at the latter date being £102,119,000. Again, if we separate the Other Deposits, as they now figure in the Bank Return, and take only the Bankers' Deposits, we find that on April 17 1929, they

stood at £60,779,000, and on April 16, 1930, they were £66,011,000

The most reasonable explanation of the general movements in the total of deposits was that made by Mr. F. Hyde in his presidential address to the Institute of Bankers on November 12, 1928. He considered that the fluctuations in "Other Deposits" are reflected in the cash held by the clearing banks, since the total deposits of the clearing banks is determined by two factors, first, the total of the cash held by them, and, secondly, the ratio which they maintain of cash to deposits. By a series of charts Mr. Hyde showed that the cash held by the clearing banks in the first six months of 1928 was decidedly less than that during the corresponding period of 1927. As he said, if there had been no change in the cash ratio of the banks a serious reduction in their deposits might have been expected. But the fact was that in 1928 the deposits were continuously above those of the previous year The explanation of the higher deposits with a reduced cash basis was to be found in a lower cash ratio of the banks. Although the actual total cash had declined by an average of about £2,000,000, the cash liberated made good this deficiency. Bankers' balances at the Bank of England, plus the bank notes held by them are their Cash Reserves, and the total represents a fairly definite and constant ratio of their total liabilities on short and maturing deposits. However, although deposits are by no means entirely dependent on good or bad trade, yet, if we regard bills of exchange and call money as a regulator of the British banking machine, the connection will be found to be close. From a study of the charts to which we have previously referred, it appears that the increase in deposits coincides with and is mainly produced by an increase in bills and call money, and that a decline in deposits is mainly effected by a reduction in these assets of the bankers.

So much for the bankers' balances. There are other points in connection with them with which we shall have

to deal; but as they necessitate a reference to Bank Rate and its working, and we are in danger of the reader's suspecting, like Horace of old, that we have stolen from blind Crispinus this scroll, we will not add more to this already long chapter.

CHAPTER VI

THE CONFLICTING CURRENTS OF DEMAND AND SUPPLY IN THE LONDON MONEY MARKET—THE PERIODIC FLUCTUATIONS IN THE VALUE OF MONEY IN THE MARKET—BANK RATE AND MARKET RATE: THEIR INTER-CONNECTION

IT will be apparent from what we have said in the previous chapter that the bulk of the money under the heading of "Bankers' Deposits" at the Bank of England represents the London bankers' balances. It is equally certain that the London bankers themselves have received the money from their clients for safe keeping—a responsibility which the bankers in turn have shifted on to the Bank of England. It will also be clear that, in principle, the bankers' balances represent a very large portion of the money stock of the London market; consequently, anything which affects the market as a whole will also quickly affect "Bankers' Deposits" as well as the "Other Accounts." If there is little or no employment for bankers' surpluses, these items will tend to rise, if, on the other hand, there is a keen demand for their spare cash, they will tend to fall. He who follows carefully the connection between trade and the money market, will also perceive that the whole total "Other Deposits" will rise when trade requires inflated figures. Generally speaking, "Other Deposits" are not idle money, to be idle they must be added to the Bank of England Reserve.

How Discount Rates are Governed.

It is plain, therefore, that the "Other Deposits" (Bankers' and Other Accounts) are really the key to the position of the London Money Market at any particular time. Some people even go so far as to say that the rates charged and paid for the use of money rise and fall with the movements in "Other Deposits." In a way that statement is true,

since, if we regard "Other Deposits" as the actual balances of the bankers and the other large concerns that keep accounts with the Bank of England, it will be clear that a superfluity of supply will be evidenced by a high level, and a scarcity by a low level of "Other Deposits" The bankers' figures are really evidence of a reserve in cash against liabilities, hence they bear a close relation to the total of the liabilities. As a matter of fact, high "Other Deposits" tend to show a weak "proportion," i e a weak position, unless the reserve of notes is proportionately high. "Other Deposits" may therefore be taken to afford an approximate test of the strength of the Market, and to explain this it is necessary to take cognizance of the rates chargeable for the use of the funds.

In the London market, as in most other money markets of the world, there are in operation two rates: Bank Rate and Market Rate.

Bank Rate.

Let us take the Bank Rate first In theory, if not in actual practice, as far as our own money market goes, the Bank Rate is the minimum rate charged by the Bank of England for discounting approved bills of exchange with not more than fifteen days to run before maturity (i e. the date at which the bills fall due to be paid by those who have accepted them); it is also said to be the rate at which the Bank of England will make advances on marketable securities for short periods, usually a week. That, however, is not strictly true, for the Bank makes a charge of half per cent over Bank Rate for loans to the market

Market Rate.

The other rate is what is known as the Market Rate, that is *the rate of interest at which the open market*, consisting of the joint stock banks, the discount houses, and the brokers, will discount bills of exchange or lend money. The Market Rate is the lower of the two, and the

reason, briefly explained, is that the immensity of the funds at the disposal of the great joint stock banks enables them to do business at lower rates than the premier institution. However, the Market Rate of the joint stock banks is itself dependent on another rate, that is the rate of interest they allow on short deposits; and as the latter rate, again, is more or less governed by the Bank of England rate, it will be realized that there is little danger of the joint stock banks breaking very far away from the Bank of England Nevertheless, in abnormal times there may be witnessed a considerable divergence in rates. For instance, in September, 1922, when the second edition of this book was in preparation, there was a difference of 2 per cent between Deposit Rate and Bank Rate. It will be seen then, that circumstances do sometimes arise which cause the Discount Rates to fall far below Bank Rate.

Influence of Bank of England.

The Bank of England, then, can in general exercise a powerful influence over the value of money in the market, the reason being that the stock of money the Bank of England itself controls forms an important part of the general supply. Further, the people who place money on deposit at interest with the joint stock banks have an awkward habit of regarding the Bank of England rate as the basis for the interest they expect to get from the outside banks. If Bank Rate be 3½ per cent, they expect to receive something near that rate themselves. Most people are familiar with the fact that the rate for short deposits allowed by the joint stock banks rises or falls with the movements in Bank Rate; but it does not do to rely too much upon that factor as a criterion of the rates allowed by the bankers themselves. A relatively large amount of the bankers' balances which figure under the main heading "Other Deposits" in the Bank Return represents current account money at the credit of their customers,

upon which no interest is paid. Consequently, the rate at which the bankers lend, or at which they discount bills, will depend upon the average rate the money costs them; when the interest they pay on deposits is spread over the whole of their balances, although some money is on long deposit at higher rates, yet the price they pay for the total sum will be comparatively small, and they will therefore be able to lend at considerably lower rates than if they had to give interest on all the money deposited with them.

When Walter Bagehot wrote his famous treatise *Lombard Street*, it was undoubtedly true that, ordinarily, there was not enough money in Lombard Street to enable all bills to be discounted withont some money being taken from the Bank of England; but with the rise of the joint stock banks, and the enormous progress they have made in the London Money Market, the influence of the Bank of England is not so great, and in normal times the market is able to absorb most of the bills offering.

As a matter of fact, the Bank of England itself has for very many years recognized the efficacy of Market Rate, and since 1878 has purchased bills from its own customers at rates similar to those obtainable on the open market.

However, it is still true that the open market during periods of change and adjnstment has more bills than it can carry or buy under discount, and in such circumstances resort is had to the Bank of England for accommodation. It seems, therefore, that the Bank even nowadays has still the last word in the matter of ultimate rates.

The nature of the control exercised by the Bank of England over the open market is plain in all times of crisis, but in practice it is also readily discernible whenever there is a scarcity of ready money. A short explanation will suffice.

The item under "Other Deposits," "Bankers," as we have said, represents the balances of the other banks with the Bank of England. Not all of this money is at the disposal

of the market, the banks, having made the Bank of England the ultimate guardian of their reserves, utilize only a portion of the money for the benefit of the open market. It should be borne in mind, however, that a deposit at the Bank of England is counted as cash by the owner of the money. Banks must always keep a proportion of their funds, usually about 15 per cent to 20 per cent of their liabilities, liquid. Up to this ratio they will meet the market's requirements by lending money or by discounting bills freely. But, if from various causes there is a pressure for money, the banks first of all begin to call in their money which has been lent out at call or at short notice; then, if the pressure continue, they either will not discount bills at all or else will decline to discount "for cash." That is to say, they will not follow their customary practice of paying cash for the bills bought under discount on the same day. In such circumstances, the unfortunate borrowers, or possessors of bills who must have the money, have no other alternative but to apply to the Bank of England for assistance. The market is then said to be "in the Bank," and the Bank of England meets the requirements of the discount houses, the bill brokers and others by discounting "approved bills of exchange" which have only a short time to run before maturity, or advances money on gilt-edged securities of the "floater" or "terminal" type, that is stocks which have only a short period to run before they mature When this happens, it is obvious that the Bank of England is in a position to dictate terms and to exact its own rates, and the price charged for accommodation is always higher than that which had been previously obtainable on the open market

There is another point. The Bank always insists upon the loans being taken for a full week at half per cent over Bank Rate, so, in the circumstances, it has thus a very effective control over the market.

The vagaries of the local demand for and supply of money are thus many, and in general the denizens of

the market are well aware of the fluctuations and cross-currents that are to be encountered day by day Both demand and supply in normal times are largely seasonal or periodic, and dealers in money, being perfectly familiar with the likely movements in its value, are able to make their plans accordingly. At least, they will do so if they are wise men ; but, as in the parable of the foolish virgins, there are not wanting those who procrastinate, and these get caught by any sudden shortage in the money market

Periods of Fluctuation.

Normally, movements in the value of money, as we have intimated, are periodic, that is so far as the London Money Market is concerned. The principal fluctuations may be roughly divided into four periods. The first is but a brief period: it lasts through the month of January; the second runs on from February to the beginning of April; the third from April to September; and the fourth from September to about the end of December

In January there is usually a plethora of money in the market, and its value in consequence runs down. The reason is that immediately after the close of the year we get the benefit of the credit that has been created by the Bank of England to carry the money market over that period, as well as the benefit arising from the large distribution of dividends by both Government and private concerns. For the first two or three weeks in January the credit thus created is roaming about the market seeking employment; there has been an expansion of credit, and the value of money consequently falls But taxes and repayments very soon absorb the surplus When the loans that have been granted by the Bank of England to carry brokers and others over the end of the year are repaid, we witness the reverse process; credit is contracted and rates move up again.

The writer noticed a striking example of this in January, 1914. There was a surfeit of money in the market and

money rates collapsed. Bank Rate was reduced on three occasions, a rare occurrence and one which foreshadowed a period of easy money In fact, before the end of January the position was so encouraging that the official minimum was put down to 3 per cent. This decline in Bank Rate quickly affected other rates, and the charge for discounting bills in the open market dropped from $4\frac{3}{4}$ per cent to $2\frac{3}{4}$ per cent Early in February the ease was even more pronounced; discount rates dropped to $1\frac{11}{16}$ per cent, and money was a drug in the market.

This brings us to the second period, one in which the market is largely under the shadow of the tax-gatherers' demands. Owing to the ingathering of revenue, stringent conditions are usually expected and experienced towards the end of the Government's financial year in March. In fact, it is in March that the balances of the Chancellor of the Exchequer with the Bank of England reach their high-water mark and, as the money is kept off the market for a time, those who require accommodation have to pay high rates for it It is rather a striking anomaly to note, too, that very little is added to "Public Deposits."

The third period—April to September—is usually a time of easier money rates and, although during those months we do sometimes witness weeks of alternate ease and plenty, we do not have the same tightness for money that is experienced during the second period. In the months in question Government expenditure is on a far larger scale than in the early part of the year, and this money, together with that distributed in dividends, adds largely to the available supplies in the market. The supplies of floating money are not, however, so large as they were in pre-war days. Payment of Income Tax in two instalments tends rather to diminish the amount of the funds available to the market.

As a matter of fact, it is in the first and third periods, when the floating supplies of money are usually on a larger scale than during the rest of the year, that the bulk

of the large capital issues, and foreign and colonial loans, are floated on the London market.

In the fourth and final period, that is from September to the end of the year,[1] the demand for money is most keen, and the price charged and paid for it, consequently, the highest of the year. This period coincides with the garnering and marketing of the world's great harvests; the movement of crops always calls for the employment of large sums of money, and if, as happens occasionally, there occurs at the same time a demand for money for other enterprises, its value will rise very quickly.

Variations and Effect on Rates.

As illustrating the movements in the value of money over the four periods in question, we may take the year 1913, that being more normal than later years

The Bank Rate in the first period was 5 per cent., and the market rate for discounting three months bills $4\frac{5}{8}$ per cent; the charge for floating money was $4\frac{1}{2}$ per cent. In the second period, February to end of March, the market rate of discount for three months bills moved up to $4\frac{15}{16}$ per cent, and the quotation for floating money to $4\frac{3}{4}$–$5\frac{1}{4}$ per cent. In April the Bank Rate was lowered to $4\frac{1}{2}$ per cent, and the market rate of discount dropped to $3\frac{9}{16}$ per cent; while by April 22 floating balances were fetching no more than 2–$2\frac{1}{2}$ per cent. Low rates prevailed for all classes of accommodation up to the end of September, when the turn came. On October 2 Bank Rate was raised to 5 per cent, and by the middle of the month, for discounting three months bills, $4\frac{7}{8}$ per cent was exacted; floating money was also quoted at $3\frac{1}{2}$ per cent. Rates continued to rule high until the end of November; the banks were charging $4\frac{1}{2}$–$4\frac{3}{4}$ per cent for market loans and $4\frac{15}{16}$ per cent for discounting three months bills; for December, rates were only slightly lower

[1] November is usually the worst month

Finally, it may be noted that the average rate charged for discounting bills of exchange in 1913 was 4·604 per cent for the first period, 4·8 per cent for the second period; 3·962 per cent for the third period; and 4·858 per cent for the fourth period

In normal times, the influx and efflux of gold to and from the country keeps pace with the value of money, that is to say, the flow of gold into the Bank of England is fairly regular when money is cheap, while the ebb is just as regular when money is dear. For instance, it was usually in the last quarter of the year when demand for money is greatest that gold tended to leave the Bank of England for abroad During the War, and for some years after, these economic forces were not allowed full play Gold movements were restricted and it was difficult to interpret money values With the restoration of the Gold Standard in May, 1925, stability was given to the measuring rod of commerce, the pound sterling, and under the Gold Standard Act of 1925 it was again linked to gold We thus got back to the position that the movements of both money values and gold tended once more to coincide

At this point it becomes necessary to enter into a detailed explanation of the use of Bank of England Rate of Discount

Gold Movements.

The system before the War was well explained by the Committee on Currency and Foreign Exchanges They showed that when the foreign exchanges were favourable to London, that is to say when the balance of trade was in favour of England, gold flowed freely into the country. When the balance of trade was unfavourable and the exchanges were adverse, it became profitable to export gold The would-be exporter bought his gold from the Bank of England and paid for it by a cheque on his account The Bank obtained the gold from the Issue Department in exchange for notes taken out of its banking

reserve, and the result was that its liabilities to depositors and its banking reserve were reduced by an equal amount; the ratio of reserve to liabilities consequently fell. If the process was repeated sufficiently often to reduce the ratio in a degree considered dangerous, the Bank raised its rate of discount, and this caused money to be left in London instead of its being remitted abroad. Money was also attracted from abroad to take advantage of the higher rate, and thus the outflow of gold was checked and the stream oft-times reversed.[1]

The reader will have gathered from what we have said earlier that all money rates in the market are intimately connected with Bank Rate, and will consequently realize that the action of the Bank of England in raising its rates was intended to bring the other lenders into line and to result in raising the general level of all other rates Except in abnormal circumstances, therefore, a rise in Bank Rate has for effect the raising of the level of money in the London Money Market, though not necessarily above the level of that ruling in Continental centres In a word, the ulterior motive is to make it unprofitable to export gold. Further, as it is known that foreign financiers are quick to seize the advantages offered, it is hoped that high interest rates, in conformity with the old economic law, will attract capital. In pre-war days the bait was sufficiently alluring, money was sent over from abroad for temporary investment in bills of exchange, and so the import of gold to replace that which had been exported was accomplished.

Checking Foreign Gold Demands.

The utility of Bank Rate for checking the foreign demand for our gold when it threatens to deplete our reserves is important, though of course it was very much more in evidence in pre-war days than now There is, however, another aspect of the question which it is easier to follow

[1] First Interim Report, Cunliffe Committee 1918.

We refer to the effect of the Bank Rate upon the home market, which is practically the same now as it was before the War.

When Bank Rate is raised, it lessens the demand for loans for business purposes, and so tends to check expenditure and to lower prices in this country, with the result that imports are discouraged and exports encouraged, and the exchanges thereby influenced in our favour.

What is aimed at, in effect, is a contraction of the currency. By raising the rate of discount and taking such steps as will make it effective in the open market, the Bank induces a general rise of interest rates and a restriction of credit. The subsequent high cost of money makes it expedient to postpone new enterprises, and the demand for constructional materials and other capital goods is lessened. What follows is a falling off in employment, and this diminishes the demand for consumable goods, while those who are carrying stocks of commodities with borrowed money, being confronted with increased interest charges, if not with actual difficulty in renewing loans, plus the prospect of falling prices, tend to press their goods on a weak market. The result is a decline in general prices in the home market, and this, by checking imports and stimulating exports, helps to restore the adverse trade balance which is usually the primary cause of the foreign demand for gold.[1]

Utility of the Bank Rate.

In this connection, the operation of the Bank Rate is interesting, and as showing its effectiveness for contracting speculative credit and reducing inflation, even when, as in 1918, the gold standard was practically suspended, we cannot do better than paraphrase the remarks of the President of the Institute of Bankers, Sir Charles Addis, who is also a Director of the Bank of England. In his address

[1] *Cf* First Interim Report on Currency and Foreign Exchanges, January, 1918.

to the London bankers on November 8, 1921, he said that on the cessation of hostilities in 1918 the Bank Rate stood at 5 per cent. It remained unchanged during the whole of 1918 and 1919. The purchasing power of Europe had declined, but the decrease was veiled by the device of "pegging," or fixing, the foreign exchanges, and prices continued to rise. From March, 1919, the upward curve was sharply accentuated by a speculative boom, which by April, 1920, had carried the price index number to the highest point then reached. The urgent necessity for prompt application of remedial measures, if a commercial crisis was to be avoided, could no longer be obscured by the sophistry of the inflationists. In April, 1920, a rise in the Bank Rate, which was indeed overdue, was made to 7 per cent.[1] What followed—whether *post hoc* or *propter hoc*, he did not pause to inquire—was remarkable. Prices fell three times as quickly as they had risen. It was doubtless considerations of this kind which led to the reduction of the Bank Rate in 1921, by successive stages, from 6½ per cent. in April to 5½ per cent in July, and to 5 per cent in November.

When Sir Charles Addis gave his speech it was, as he remarked, too soon to judge definitely of the result; but subsequent events showed that the lowering of the Bank Rate brought about easier monetary conditions and a resumption of activity in the stock and share markets. This brightening influence soon spread to other markets, financial facilities for trade were easier to obtain from the banks, and a slow but steady improvement in trade was noticeable.

We thus get proof of the natural, if curious, corollary that a change in the Bank Rate operates directly on the mind of man in predisposing him to a certain course of action. Its connection, however, is mainly indirect in producing the conditions, or, "if one may say so, the

[1] Well informed critics question the paramount influence of the rise in Bank Rate on this occasion

atmosphere congenial to the free functioning of the economic forces of supply and demand. A rise in Bank Rate is the danger signal, the red light warning the business community of rocks ahead on the course in which they are engaged. A fall in Bank Rate is the green light indicating that the coast is clear and that the ship of commerce may proceed on her way with caution. . . . In the Bank Rate, whether for a rise or a fall, we have an instrument of which the action has indeed been obstructed by the adverse circumstances of the Peace, but whose efficiency for ultimately producing the financial result desired remains unimpaired by anything that has happened during or since the War They are not without grounds for their belief who hold more strongly than ever that in the suppleness of the Bank Rate lies its chief virtue, and that its efficacy, especially in the way of prevention, would be increased to the great advantage of the community if it were more frequently and above all, more promptly applied There is a sentimental prejudice against changes in the Bank Rate which has no real economic justification. In any case, the disadvantages attaching to frequent changes in the Bank Rate are as dust in the balance when weighed against the supreme advantage to trade of comparative stability of prices."

We have little to add to this well-reasoned statement by one of the Bank's own directors on the utility of Bank Rate But there remains to be considered another point in connection with its working, and that is the degree to which the open market responds to a rise.

Now, for Bank Rate to be really and thoroughly effective, that rate and Market Rate must be reciprocal. But are they? The reply is, "Not always!"

We have seen that the main object of the raising of the Bank Rate is to stop the outflow of gold and to influence the inflow by attracting money to London from abroad for investment. As a means to this end, the Bank of England also endeavours, by influencing money rates in

London, to contract credit and, *pari passu*, currency. The measure of its success in this manipulation depends upon the support the Bank of England receives from the other possessors of funds in the London Money Market. This support is easy enough to obtain if there is a comparative shortage of funds; but if money is in good supply, as evidenced by a high level of "Other Deposits," the Bank of England will, in the early stages, be practically powerless to influence rates upward, because the outside lenders will compete the one with the other to lend money and so force down rates.

"Budla-ing."

As all rates are inter-connected, the Bank of England could, of course, ultimately bring the outside market up to the desired level simply by raising its rate again and again until its object was attained. But there are now obvious difficulties and objections to such a course. In pre-war days, what the Bank used to do in such circumstances was to follow the line of least resistance and relieve the market of its surplus funds by taking upon itself the mantle of the borrower. The operation usually carried out was a simple one and, in Eastern parlance, it is known as "budla-ing" To "budla" the market is to sell a commodity for cash and buy it back again for forward delivery What the Bank of England did was to sell Consols for cash and to buy them back for the "account," the "account" being the monthly settlement day which used to rule on the Stock Exchange before the War. Purchasers of Consols for cash were required to pay for them the following day and, the payments being made in the usual way by cheques on their bankers, the net result was that, after the cheques had passed through the London Clearing, the bankers' balances at the Bank of England would be correspondingly reduced. That is to say, "Other Deposits" at the Bank of England would fall and, with the supply of money reduced to that extent, borrowers would go unsatisfied

unless they paid the higher rates, since the remaining money would have a "scarcity" value.

This was an effective and successful device for assisting the Bank of England to regain and to maintain its control over the market. During the War, and after, this method has been unnecessary. The monthly settlement on the Stock Exchange was stopped soon after the War, and was not re-introduced until May 29, 1922. From August, 1914, to the latter date, dealings for the most part were entirely on a cash basis. Further, the existence of so large an amount of Treasury Bills, concerning which we shall have more to say at a later stage, has entirely altered the control of the market. The sales of the British Government's Treasury Bills in recent days have been a ready and effective means of absorbing any surplus funds that might be on the market, and it would be a simple matter to keep the money received in exchange for these bills off the market for a time if circumstances warranted it. Though the fact that such an expedient has never been resorted to, and in the opinion of experts, is most unlikely to be, is a compliment to the Bank's power over the market. In practice, the money is quickly returned to the market through the usual channel of Government payments to contractors and others; but there are doubtless times when considerable sums received from the sale of Treasury Bills go to repay the Bank of England for its loans on Ways and Means advances, and the money so repaid, being immediately under the control of the Bank, may be released to the market or not according to the discretion of the authorities. Nowadays, too, if the Bank considers it expedient to cause a hardening of the open market rates, it simply sells Treasury Bills for spot cash, thus taking an amount of money off the market and making Bank Rate fully effective. As far as the Bank Return goes, these sales of Treasury Bills are reflected in the account of the Banking Department: the item on the Assets side, "Government Securities" will be reduced, and on the Liabilities side there will be a diminution in the item

"Bankers" under "Other Deposits." Moreover, whenever the outside market is forced to go to the Bank for accommodation, the Bank at that point has control of the market and can charge rates for lending high enough to bring the other dealers in money up to the desired level. Then, again, circumstances may arise in which, although Bank Rate is fully effective in controlling the open market rates, stringent conditions are likely to result in the market. Floating supplies are becoming exhausted, and in default of action by the Bank, money market operators might be forced to apply to the central institution for loans. The Bank of England, however, has always its finger on the pulse of the market, and should any such danger of contraction appear, the Bank quickly secures expansion in the money supply by buying bills on the open market through its brokers, thus increasing the supply of "Bank Cash."

There is still one other method of dealing with money rates by the Bank of England that ought to be noticed before we leave this part of our study.

Home and Foreign Rates.

After the outbreak of the War, and for some time prior to October, 1917, a large number of people had urged that relatively low rates should be offered for home money and charged on domestic loans, while at the same time gold should be prevented from leaving the country by the offer of high rates for foreign money. In deference to public opinion, this policy of having a differential rate for home and foreign money was adopted by the Bank of England, and on November 15, 1917, a start was made by its allowing 4½ per cent on deposits of foreign money made through the clearing banks, against 4 per cent for home or "domestic" money. This practice was maintained for a considerable time, but it is doubtful whether it was ever of much utility beyond affording the banks a ready means of procuring a relatively high rate of interest on

foreign funds if they found they could not be employed to advantage on the London market. However, there were stringent safeguards, and money was not accepted and treated as foreign money without careful investigation.

In their interim report, the Currency and Foreign Exchanges Committee recommended a discontinuance of the practice, since, as they said, any attempt to maintain this differentiation must inevitably break down, because it would be impracticable to prevent people from borrowing at the low home rate and trying in one way or another to re-lend at the high foreign rate. They were of opinion that it could only be prevented, if at all, by the maintenance of such stringent restrictions upon the freedom of investment as would be most detrimental to the financial and industrial recovery of this country; and, even if the differentiation were practicable, the Committee held it was not desirable for this reason The low home rate, by fostering large loans and keeping up prices, would continue to encourage imports and discourage exports; and, even if the high rate offered for foreign money prevented gold from being drawn abroad, it would only do this at the cost of piling up an ever-growing debt from Englishmen to foreigners

In the face of this recommendation, it was deemed expedient to drop the practice, but it was done by easy stages On January 2, 1918, the Bank of England reduced its rate of interest on deposits of domestic money from the London Clearing Banks from 4 per cent to 3½ per cent; and on February 14, 1918, the rate was still further reduced to 3 per cent. The rate on foreign money was not altered and remained at 4½ per cent. On January 8, 1919, however, a start was made by the Bank of England's intimating that as the French, Italian, and Belgian exchanges were in favour of London, the special rate of 4½ per cent allowed for foreign money would not be applicable to French, Belgian, and Italian deposits. Then on January 13, 1919, it was decided that the rate

allowed to French, Italian, and Belgian depositors should not exceed $3\frac{1}{2}$ per cent. On July 23, 1919, the Bank of England also ceased to allow 3 per cent on three-day deposits from the clearing banks. This was an important measure and has not received sufficient attention. We doubt, in fact, whether many people realized the true inwardness of the situation. For instance, if some of the Bank of England Returns and those of the Government for the periods in question are compared, it will be patent to a close observer that the figures do not tally, as the borrowings from the Bank of England shown in the Government Returns apparently exceed the total of Government securities shown in the Bank of England Returns. The explanation appears to be that the Bank was merely acting as agent for the clearing banks' loans, in the shape of these deposits at interest, to the Government, and did not include such loans in its own figures.

On July 30 the Bank ceased to allow interest on all existing home deposits. The rate on certain foreign balances, however, remained unaltered, and was not finally dropped until October 18, 1919.

CHAPTER VII

THE SHORT LOAN FUND OF THE LONDON MONEY MARKET

HAVING examined some of the principal features of demand and supply in the London Money Market, we now come to a consideration of one of the most interesting and, at the same time, one of the most puzzling sections of the market. We use the word "puzzling" advisedly, because we have to treat here of something that even the oldest dealers in money say is as intangible as it is elusive. We refer to the Short Loan Fund of the London Money Market.

Well, what is this short loan fund?

If the reader expects to be told that there is a certain sum of money in existence to which we can point at any particular moment and say, "This is the Short Loan Fund," he will be disappointed, since in reality there is no fixed sum which comprises the fund. All we can say, all we are entitled to say, is that the phrase "Short Loan Fund" is merely used for convenience to express the total of short loans running at any particular time. It is not a fund at all in the sense of being a reservoir or cistern which has definable limits. That is why some people say the short loan fund is elusive; it is difficult to grasp what and where it really is. The trouble is that the short loan fund is a fluctuating item in the money market, and one can never be quite certain what is the precise amount the lenders can hold at the disposal of borrowers. The fund is not unlimited, and from time to time is subject to dislocation, but in normal times the movements are skilfully handled

During the War, when the London bankers ceased to issue periodical statements of their position, it was impossible to say, even approximately, what sum of money was at the disposal of the market. However, now that the

London clearing bankers have resumed the issue of their monthly statements, we are in a position to judge with a fair degree of accuracy the sum they contribute to the short loan fund by taking the total of their money at call and short notice. Statements of the position of the clearing banks are issued monthly, and these form a useful index from which we may calculate the amount of the floating funds available. The principal daily papers, also the weekly economic journals, give full prominence to these details, and the reader would do well to study them.

Money at Call and at Short Notice.

In a comparative statement of the accounts of sixteen English joint stock banks for the year 1936,[1] there appeared the item "Money at Call and Short Notice," the aggregate amount of which was £204,324,734 This sum, being actually lent to the market for short periods, may be fairly described as constituting the major portion of the short loan fund, though it does not represent the whole of the available fund There are variations in this amount from month to month, but taking the average weekly balance of "Money at Call and Short Notice" shown by nine clearing banks for November, 1937, we get a tolerably clear estimate of the size of the short loan fund. Even so, we are fain to admit that it is mainly a question of practice only, and the claim of a critic that the figures do not reveal even the practical limit of the short loan fund is probably correct.

The point at issue between many bankers who have discussed the matter is what amount, if any, is contributed to the fund by the other interests, to wit, the other banks and discount houses. For ourselves, we are inclined to eliminate the discount houses from our estimate, and for this reason: granted that the discount companies, and even the discount brokers, are large lenders at times, yet, strictly speaking, that is not the essential part of their business. They are more properly concerned with buying

[1] Published by the *Economist*, May 15, 1937

and selling bills of exchange under discount. That is to say, they purchase bills of exchange for a certain percentage below their face value and sell these bills to their clients, bankers and others, at a profit; and though it does frequently happen that they have more money at their disposal than can be employed in the bill business, they cannot be regarded as such constant lenders as the clearing banks themselves. Moreover, if we included their money in our total of the short loan fund, it would be just as correct to include the item in the banks' statements shown under the heading of "Bills Discounted," to do which would be to give an entirely incorrect meaning to the short loan fund

The discount houses really borrow about as much as they lend, with the exception of their capital. Their deposits received from the public are comparatively small.

Figures for British Banks.

There remains the question of the other banks. In its issue of May 15, 1937, the *Economist* gave the figures of the joint stock banks of England and Scotland, and by adding together the totals of money at call and short notice under each section, we get a sum of £232,794,000 for the banks of the two countries. The aggregate total of the money at call and short notice of eight London clearing banks given by the *Economist* was £164,800,000, so, if we deduct this amount from the total for all the banks, the sum lent out at call and short notice by the remaining joint stock banks of the two countries in round figures is £67,994 000, and what proportion of this amount represents their quota to the short loan fund of the London market it is hard to say, the probability is that it is very small, because the larger portion of the floating balances of the banks in question is utilized in their own local markets.

Foreign and Colonial Contributions.

Finally, there are the figures of the foreign and colonial

banks with London offices. Just what their contribution to the fund amounts to must be entirely a matter of conjecture. Most of them, of course, show the item " Money at Call and Short Notice " ; but as this includes money so employed in their own countries, and also remittances *en route* to London, the sum employed here is, as we have said, purely conjectural. The possibility is that their portion of the money on the market is very small, for the very simple reason that it is no part of either the foreign or the colonial banks' business to utilize money on the London market other than temporarily The foreign and colonial banks are frequently lenders to the open market, but only during such times as they have money waiting to be employed in the finance of exports from this country. These banks also finance the exports from foreign and colonial centres to this country ; the bills representing our imports are presented for acceptance by their London offices to the persons upon whom they are drawn, and then the greater proportion of the bills are sold to the London discount market. The proceeds received from the sale of bills by the foreign and colonial banks are subsequently used by them to purchase other bills drawn in connection with exports from this country, and it is only during the interval between the receipt of the money and its utilization for the purchase of foreign bills that their funds go to swell the floating balances on the London market

Totals of the Clearing Banks.

It follows from what we have said that, by taking the average weekly total of the money at call and short notice shown by the London clearing banks, we have an approximately correct figure to represent the short loan fund of the London Money Market We make this proviso, however ; the fund is elastic, and the lendable amount, on an ultimate analysis, may be said to depend upon the greater or less willingness of the banks to extend their short loans to the market.

The average weekly balance in November, 1937, of the London clearing banks was £160,469,000.

As a matter of fact, this sum, representing the short loan fund of the London Money Market, has increased with the increase in the creation of credit by the banks, though we would not go so far as to say that the difference between the amount of the short loan fund at one period and that at another represented the actual increase in credit in that time.[1]

It is often stated that during and since the War the floating credit in the London Money Market based upon the amount of gold held is more slender than even the most adventurous of our old-time bankers deemed either possible or safe. In this connection, reference is constantly made to the gold coin and bullion held in the Bank of England, and the amount of credit which it is said the bankers have created on that gold as a basis. The present author has never held the view that such a comparison was anything more than hypothetical; nevertheless, in view of the general interest taken in the matter, he was led to compare the relative position of the various factors in 1922 with those of twenty years ago. Comparison was made between the two periods because each are years just after great wars. The result of his investigation gave the following curious facts.

In February, 1902, a London banker[1] estimated the short loan fund of the London Money Market to be about £70,000,000. If we take the amount of gold held in the Bank of England on February 5, 1902, £34,125,000, as representing the basis for the credit, we find that for every £100 of credit in the short loan fund there was then held £48 of gold. Almost exactly twenty years later the short loan fund was £118,840,000, and the gold in the Bank of England at the same time (on February 8, 1922, to be precise) was £128,762,000; consequently, for each £100

[1] *Cf* Chapter VIII on average rates for short loans and discounts for nine years to December 31, 1937.

of credit in the short loan fund there was held about £108 in gold, or more than double that held for every £100 of credit in 1902. If we accept this hypothesis, then, the short loan fund in 1922 was on a very much sounder basis than in 1902.

We must admit, however, that such reasoning is purely hypothetical, but it does serve to show how careful one should be to investigate the position before accepting the loose statements that are frequently made It gives emphasis, too, to the remarks we made in our first chapter about the necessity for the student to think things out for himself.

Gold Reserves and the Fund.

Nevertheless, that there is some connection between the gold and the short loan fund of the London Money Market is indubitably true. It arises in this manner. Under the English Coinage Act of 1870, any person was entitled to take gold bullion to the Bank of England and to receive in exchange sovereigns at the rate of 77s. 9d. for every ounce of standard gold delivered to the Bank. Since the advent of the Gold Standard Act of 1925, the Currency and Bank Notes Act of 1928, and the Gold Standard (Amendment) Act, 1931, however, sovereigns are no longer handed out Nevertheless, although under the 1925 Act the Bank was not obliged to part with sovereigns, it was its practice to deliver them for export up to September 17, 1931. But banks who are importers of gold may still present their bullion to the Bank of England and either take out currency, or may have the value of the gold, at the rate of 77s. 9d. per standard ounce, put to their credit with the Bank of England. If, as often used to happen, a banker proceeded to lend out his money on the short loan fund of the London market, such addition to the fund was clearly an increase in the amount of floating credit already in

[1] J. Herbert Tritton, Esq.

existence. By his action the banker added to the short loan fund.

As showing how all the various interests in the London market are interwoven, we may here insert a few remarks on the actual manner in which imports of gold were dealt with by the Bank of England prior to the temporary suspension of the Gold Bullion Standard, following the Gold Standard (Amendment) Act, 1931, since the connection is not so remote as it might appear on the face of it.

Bankers and Gold Imports.

When a banker or any other person imported gold, he could, if he so desired, tender the metal, either directly or through a bullion broker, to the Banking Department of the Bank of England. Under the Bank Charter Act of 1844 the Bank of England is still obliged to buy gold at 77s. 9d. per standard ounce (i e. gold $\frac{11}{12}$ths fine); this corresponds to a price of 84s 9·8181d per ounce fine

Gold Movements and Bank Return.

When the Bank of England receives gold bullion, it is the practice for the Banking Department to credit the account of the importer or his agent with the value on the above-mentioned basis. The gold is then automatically passed on to the Issue Department in exchange for Bank of England notes The net result of such a transaction or transactions would be seen in the next Return of the Banking Department by an increase on the debit side in "Other Deposits," for the customer's account would have been credited with the equivalent at £3 17s. 9d. per ounce. On the credit side of the Banking Department, again, there would also appear an increase under the heading of "Notes." The Issue Department's account would also show on the debit side an increase in the "Notes Issued," and on the credit side an increase in "Gold Bullion and Coin."

This is rather a digression from the subject of our

chapter, but it will serve to help the reader to appreciate the importance of the many influences in the market, and help to illustrate how closely the separate parts of the wheel are related to the hub, the Bank of England.

Fund's Apparent Inelasticity.

Well, to return to the short loan fund, probably the first thing which will strike anyone who studies casually the working of this fund will be its apparent inelasticity. We use this term because, in practice, the short loan fund seems able to respond to the demand made upon it by operators only up to a point, that at which the banks cease to be lenders and proceed to call in money from the market When this happens, it is the short loan fund that is the first to feel the pinch. The supply of floating money does not greatly vary from day to day, the money supply simply changes hands, and if, as we maintain, the major portion of the short loan fund is held by the banks, then, when in consequence of the demand made upon him, one banker is obliged to call funds from the market, the amount automatically finds its way into the till of another banker. That being so, the latter is merely in a position to lend precisely the amount the first banker has "called" The operation, therefore, appears to be simply an exchange, and no new augmentation of the fund has taken place.

Prior to Great Britain's departure from the Gold Standard on September 21, 1931, when a new import of gold arrived in the country, the operation, as we have seen, was different. The fund was increased by the equivalent value of the gold released to the market, for it was absolutely new money. That is what we meant when we said in the beginning of this chapter that the short loan fund was not a reservoir or cistern with definable limits. The more correct way to regard the short loan fund seems to be to liken it to a reservoir into which and out of which streams of money are flowing every day, year in and year out, and sometimes the contents are at one level and sometimes at

another. If the reader has understood the movements in money to which we have referred in the preceding chapter, he will appreciate the connection.

Controversy Between Bankers.

The application of this simile some years ago formed the subject of considerable controversy between leading London bankers On the one side it was considered that the short loan fund might be compared with a reservoir with various divisions, of which the open market and the Bank of England were the chief. The Bank of England compartment was further sub divided into "Other Deposits Compartment" and "Government Deposits Compartment."

The outcome of the argument appeared to be that the short loan fund was inelastic, because at a given point, that at which the last of the bankers had called in his money from the market and had refused to re-lend the money, the market no longer responded to the calls made upon it The reservoir was empty as far as the bankers outside the Bank of England were concerned.

The movements between "Other Deposits" and "Government Deposits," together with the relief occasioned by Government disbursements of funds, have been sufficiently traced in our last chapter. We need, therefore, only refer to the apparent inelasticity caused by the depletion of the short loan fund

If we regard the whole of the short loan fund of the London market to be purely and solely in the hands of the clearing banks, and exclude the Bank of England, then there appears to be some justice for the claim that the fund is inelastic. It is, of course, really a question of demand and supply; if supply was illimitable, there would be nothing to worry about in connection with demand, but that the money supply is limited, and that demand does often out-distance supply, is unquestionable. But, as we shall presently see, this is excluding the Bank of England from the position.

Replenishing the Fund.

It is held in some quarters that the short loan fund can always be replenished in the absence of other supplies by the simple operation of selling bills under discount. But there are times when the outside market positively will not discount a single bill, and although the Bank of England in such circumstances does come to the rescue—at a price—that is rather another story. However, granted that there is some inelasticity, the height appears to be reached when the other banks either have lent all their available surpluses, or, owing to their need of money in other directions, have withdrawn all their surpluses from the short loan fund. It is precisely at this point that we see more clearly the part taken by the Bank of England. In practice, the central institution is always willing to discount or to lend money upon the security of approved first-class bills of exchange; but, as in most cases the loans are for somewhat longer periods than that for which loans are made from the short loan fund by the outside banks, it is not strictly correct to regard the accommodation by the Bank of England as emanating from the short loan fund itself. Nevertheless, there are not wanting those who maintain that the short loan fund is never exhausted and, as the market can always rely upon the Bank of England to assist in the last resort, it is simply a question of a higher price being paid for money out of the same fund

The apparent inelasticity of the fund was once described by a Governor of the Bank of England to be in reality evidence of the efficiency of the short loan fund of the London market, and what he meant by "efficiency" was that the total available funds in the market in the halcyon gold circulation days were in constant use. In itself, this is not a bad thing, since it implies that on the least strain or dislocation of the machinery of the short loan fund recourse has to be made to what might be called the emergency part of the fund, which is held for such contingencies by the Bank of England. In reality there is

no actual fund held by the Bank for the purpose. By a book entry it creates money to lend, and it lends at the expense of its "proportion." That is why some critics hold that a loan from the Bank of England is in the nature of inflation.

There is another point to be remembered. If the money the other banks call from the market, or rather the whole of it, is paid into their accounts with the Bank of England, then when the Bank takes upon itself the role of lender, it may be argued that it is simply a case of the Bank of England's lending out the balances received from the other banks, and so returning to the short loan fund the money that had previously been withdrawn. All of this goes to show how curiously intricate and how interconnected are the many parts of the machinery of the London Money Market.

Increasing the Balances.

This transference of loan power is best seen when the demands on the bankers are heavy; then, and also at times when they wish to show substantial balances at the Bank of England, the banks replenish and even increase these balances, and to do this they call in their floating balances from the market. In other words, the banks transfer the responsibility for lending the money of the short loan fund of the money market on to the Bank of England, which, as we have seen, steps into the breach and makes the money re-available.

In these circumstances, the inelasticity is seen to be not so serious as it might be, and in general the short loan fund promptly adjusts itself to the demand made upon it, though, temporarily, recourse to the Bank of England may be necessary while the adjustments are being made. Even then it is not a question of an increase or decrease in the amount of the fund, but of an increase in the rate of interest charged and paid for its use.

It has been said by some authorities that whenever the

Bank of England makes an advance, the short loan fund must of necessity be increased; but we must be careful before accepting such statements, since, as we have seen, when the Bank of England is the only lender, it is something more than a transference of lending power from one of the clearing banks. It is at the expense of a reduction of the reserve ratio of the Bank of England. If, however, the Bank of England brings its mite into the short loan fund at the same time as the other banks are lending—and this, in fact, it does do, because the Bank usually does business with its own customers on the same terms as the open market—then its advances increase the short loan fund, because the Bank of England has no need to withdraw from the short loan fund an equivalent amount as the other banks need to do. The amount so advanced inevitably goes to swell the "Other Deposits" (Bankers') which, in the absence of disturbing influences, mount up *pari passu* with "Other Securities" when the increase of these is caused by loans to customers; or, if the advances have been to the Government, "Government Deposits," apart again from disturbing influences, mount up *pari passu* with Government securities. When the Bank of England makes loans, its customers naturally draw against those loans, but the money so drawn out returns immediately, because the cheques are paid into banks by those who receive them, and quickly appear to the credit of other accounts in the Bank of England's ledgers, thus illustrating the supreme position the Bank of England occupies in the money market.

We have referred to the circumstances in which the short loan fund may be increased, and it may be well, therefore, to consider how a decrease is effected.

How a Decrease Results.

A decrease, like an increase, is brought about by internal and external market conditions that affect the regular and irregular ebb and flow of gold. It is at least questionable in these times whether any outflow of gold can be termed

regular; but in the pre-war times there was always a periodic withdrawal of gold towards the end of each quarter—the Scotch drain at term time in May and November, the harvest drain and the holiday drain for England are illustrative of this. Frequently these withdrawals of gold took place at a time when other calls upon the banks were heavy and, as the amount required had in most cases to be withdrawn from the short loan fund by the London bankers upon whom the demand for gold fell, it served to accentuate the stringency. Such movements were, however, well known, and allowance was made by the bankers for them in estimating market resources. Nowadays, when so much of our currency has given place to paper, the movements of gold are less easy to connect with the internal monetary circulation. In a word, gold in 1932, as currency, does not move at all in the United Kingdom—as one critic of the first edition wrote the author. It is not a floating or circulating currency.

Foreign Movements of Gold.

However, it is the foreign movements of gold coin and bullion which are of importance at the present time. They are not subject to periodicity like the domestic demand and, with the handling of gold limited to a few persons in England the public does not take the same interest in the matter as it did before the War.

The imports and exports of gold are subject to no such periodicity; the movements in normal times depend on the exigencies of the exchange situation.

To avoid misunderstanding it is as well to point out that although the Gold Standard Act of 1925 suspended the free coinage of gold, yet, under Section 11 of the Currency and Bank Notes Act of 1928, the activities of the London bullion market are left untouched. Further, although under the terms of the Gold Standard (Amendment) Act, 1931, the Bank of England is relieved of the obligation to sell gold bullion at 77s. 10½d. per standard ounce, the open

bullion market is left free to dispose of gold imported into the country to whom it likes. The Act of 1931, in fact, does not affect gold dealing in the open market, and the market price of gold is now governed by the movements in the foreign exchanges with those countries still on the gold standard. We shall discuss this question of the bullion market's operations in gold at a later stage. Under the system in vogue prior to Great Britain's departure from gold, in effect the amount of gold that could be withdrawn from the Bank for export was represented by the amount of notes in reserve.

An exporter of gold, before he could procure the metal, had to provide the funds against which the cheque for the gold was drawn upon the Bank of England. Suppose one of the banks in London desired to export gold to America, it used to arrange the purchase through a bullion broker, who claimed the value directly he had sent in the contract of purchase to the bank. The banker paid for the gold by cheque drawn on its own banker, probably the Bank of England; he did not want to overdraw his account, so funds had to be provided to meet the cheque or cheques drawn, and this was done in one of several ways. First, it was perhaps necessary for the banker to call in his loans from the short loan fund of the market; secondly, he might be obliged to sell bills under discount in order to get the money, or, finally, he sometimes was forced to borrow from the market to make up any deficiency on his finance book for the day. Whichever method he adopted, it was certain that the short loan fund of the London Money Market would eventually be reduced, either directly or indirectly When these operations were of any magnitude, like those witnessed prior to September 21, 1931, when amounts as large as a million sterling of gold at a time were shipped to France or the U.S.A., the resulting reduction in the short loans inevitably led to an enhanced rate of interest for loanable funds; unless, of course, as sometimes happened, the operation coincided with fresh creation of credit by the

Bank of England itself making extra advances, and thus counteracting the adverse effects caused by the outflow of gold. If the Bank of England was not a lender, then "Other Deposits" (Bankers') tended to show a decline during the outflow of gold, though special circumstances frequently marked the process.

When gold came into the country, the importing house, as we have seen previously, had the equivalent value placed to the credit of its account immediately the Bank received the metal, and we may assume that the money was usually applied forthwith in the short loan fund of the market.

Peculiarities in the Variations.

To return to the export of gold, when loans made by the Bank of England were the result of a temporary internal demand such as was experienced early in 1922, when many big loans were raised on the London market, then there was no occasion for the Bank of England to raise its rate On the other hand, when the borrowing by the market was due to a curtailment of the short loan fund through gold being exported (for in normal times every export of gold reduces the amount of the bankers' balances), then the Bank of England had to consider the advisability of raising its rate immediately in order to stop the outflow of gold or to replenish its reserve. The circumstances were constantly varying, and the Bank of England Court of Directors had to base its action on those existing at any particular time.

With the country temporarily off the gold standard such conditions no longer prevail, and with official operations so frequently taking place, it is difficult, if not impossible, to trace the result of gold movements. However, there is still a certain amount of truth in the statement that we can increase our stock of gold only by attracting the metal from abroad, and to do this we have to raise the value of money in the London centre to a higher level than it is in foreign centres. It may mean several increases in the rate of interest

offered, but sooner or later the rate does reach the level at which foreign financiers are willing to employ more credits on the London market; so eventually they are persuaded to ship gold, and this operation, as soon as the gold arrives, broadens the basis of our credit structure Finally, it tides us over until such times as the high interest charge works out its own cure by curtailing credit.

One other peculiarity of the movements in the short loan fund remains to be noticed. The London market often witnesses the seeming anomaly of a diminution in the fund and a consequent tightness of money concurrent with an increase in the total of "Other Deposits" (Bankers') in the Bank of England. This is a sore puzzle to some people, so perhaps a brief explanation will suffice to make the reasons for this state of affairs plain.

Banks' "Window-dressing."

Periodically, the banks resort to a device known to the City editors of the newspapers as "Window-dressing" That is to say, at times it is considered to be advisable for the banks to show in their balance sheets large amounts of cash in hand and at the Bank of England It is sometimes done just before the publication of the monthly statements, and almost always at the half-yearly balancing and publication of accounts. To accomplish the desired result, the banks either let their loans run off, or else call in money from the short loan fund of the market. It may be a matter of comfort for those who hold bank shares, or who have large sums of money on deposit with the banks, to know that the particular institution in which they are interested has plenty of "Cash in Hand," but a moment's thought would possibly convince them that the custom was the reverse of profitable for the banks

We need hardly point out that it is not a case of the banks' borrowing from the market in order to be able to show a liquid position; they simply allow the contents of their bill portfolios to run down, and otherwise gather

up any surplus funds they may have out on the market. In a word, the money they do show is the banks' own property, not borrowed funds. The practice, of course, is well understood by most money dealers, who affect to be amused that bankers in these enlightened days still think it necessary to resort to a little artifice which deceives no one who is at all cognizant of the working of the market.

Few people defend the action of the banks ; a good many condemn it, but actually the practice does little harm to anyone except the banks, who are slightly the losers over the transaction, as the money they lock up for short periods earns no interest.

Nevertheless, it is not always for balance sheet purposes that this so-called window-dressing takes place. The banks often call in money in preparation for the large dividend payments due at the end of each half-year.

Whatever the reasons for the practice, the result is usually to force those who are accustomed to rely upon the short loan fund for accommodation to go to the Bank of England for assistance, the extent of which is frequently revealed by a large increase in "Other Securities" at the Bank of England.

Twelve Points on the Fund.

These are all matters which, as we have said, the bankers themselves have discussed over and over again ; and, as a fitting conclusion to this chapter, we cannot do better than quote twelve points made by Mr. Alfred Clayton Cole, who at one time was a Governor of the Bank of England—

1 The London Money Market is so elastic that it will, *at a rate*, always respond to the demand made upon it.

2 The deposits of the banks are made as either cash deposits or credit deposits. The bankers themselves create all their credit deposits.

3. They create these credit deposits in the proportion that they maintain between their cash and their liabilities.

The credit deposits increase or decrease according as the proportion decreases or increases.

4. The banks themselves decide what the proportion shall be.

5. It is the practice of the banks to extend the creation of credit so that they only retain the minimum proportion of cash which they consider necessary for their own safety.

6. As soon as the safety limit is passed, the banks have to call in loans to regain their necessary minimum proportion of cash, and the market has to borrow at the Bank of England.

7. As soon as such borrowing begins at the Bank of England, the latter obtains control of the market.

8. As the banks usually work up to the safety limit, a very slight displacement of money will, as a rule, necessitate borrowing at the Bank of England.

9. If the bankers decide to increase the aggregate of their balances at the Bank of England, they can do so only with the co-operation of the Bank of England itself.

10. The nature of the credit created by the Bank of England is the same as that created by other banks.

11. Unless loans made by the Bank of England are withdrawn in cash, the loans do not affect the reserve of the Bank of England, but only its "proportion," that is the ratio of its reserve to its liabilities on deposits. This is the same in effect as loans made by other banks and the Bank of England decides whether its "proportion" at any time is sufficient.

12. If the Bank of England decides that it is desirable to check gold exports from this country, or that more gold must be attracted from abroad as the basis of credit in this market, it will raise its minimum rate of discount, in the reverse case it will lower its rate, in the interests of the trade of the country.

CHAPTER VIII

THE OPEN MARKET AND THE DISCOUNT MARKET

It is natural to pass from a consideration of the short loan fund to an examination of the discount or open market, because the two are intimately connected. The discount market is one of the most important sections of the London Money Market, and it might be advisable, therefore, if we start by defining the terms "discounting" and "discounted"

"Discounting" Defined.

The word "discounting," as an eminent K.C.[1] once pointed out, is used indiscriminately either to describe the position of the person who negotiates a bill for value prior to maturity, the amount the seller of the bill receives being less than the value in proportion to the unexpired term of the bill, or to designate the position of the party who takes over the bill and who gives such reduced value to the transferor. In view of this apparent ambiguity, the reader would do well to remember that to discount a bill is to buy it, or, as Sir John Paget describes it, to become the transferee of the bill by having it indorsed or transferred by delivery by the holder, for a price settled either by agreement or by the current market rate of discount A discounter is the person who buys the bill; while the one who gets the bill discounted, that is sells it, is the transferor.

London Bankers' Dealings.

The London joint stock bankers, as a rule, do not deal direct with the buyers and sellers of bills on the discount

[1] *Cf* "Gilbart Lectures," by Sir J R. Paget. *Institute of Bankers' Journal*, Vol. XXXIII (p. 219).

market. The intermediary through whom most of the operations are conducted is the bill broker; and in order to appreciate the necessity for the presence of this middleman on the London Money Market it is necessary to remember to what a fine art the financing of commercial operations in London, the monetary centre of the world, has been reduced. Cognizance must also be taken of the enormous growth of our joint stock system, both in banking and in commercial concerns. The conditions under which the modern bank manager works are vastly different from those which ruled in the peaceful days of the old private bankers; it would be hardly possible in these days, when the banking of the country has centred in the hands of a few big concerns, and when a general manager is a sort of superman who has to be responsible for hundreds of branches, for him to be expected to go from place to place to attend to the selling of bills under discount. As the author has shown in another work,[1] not the least important of the operations with which the present-day banker is concerned is the acceptance, collection, and discounting of bills of exchange; and, although the banker does exercise a careful control over the main part of the business, his multitudinous duties permit of neither personal visits to the dealers in bills nor his attendance on the open market.

The Bill Brokers.

It is for these reasons that most of the discount business is conducted by the bill specialists, bill brokers, and the discount houses.

To understand the business properly, it is, first of all, necessary to pay an imaginary visit to the London offices of the banks principally concerned in these operations On the one band, we have what might be called the original possessors of the major portion of bills for discount, the

[1] *Foreign Exchange and Foreign Bills in Theory and in Practice*, by W. F Spalding. (Sir Isaac Pitman & Sons, Ltd)

London offices of the colonial and foreign branch banks. On the other hand, we have the London offices of the joint stock banks. Just what business each will do on the discount market is determined by the day-to-day position of their finances

The Banks' Finance Book.

The manager of each class of bank has a finance book. On the one side there will be a record of the amounts to be received, and on the other side a record of the amounts to be paid.

The manager of the foreign or colonial branch bank will have under his eye the balances at his own bankers brought forward from the previous day; it may be with one of the big clearing banks or at the Bank of England; probably he has balances with both At the commencement of the day, on the debit side of this finance book, will be the first item, the balances or balances in hand and at bankers. Then will appear the amounts the bank knows it will receive during the day or expects to receive. Should any other unforeseen items be received, these also are placed on the debit side. With a foreign or colonial bank, these items include cheques received for the credit of customers' accounts, or for bills maturing and documents of like nature falling due to be paid by clients. If the bank in question is a dealer in bullion, there will also appear amounts due for the sale of gold and silver, whether in bullion or in coin; money received as the result of telegraphic remittances from abroad, known as telegraphic transfers; money received from customers to be placed on deposit for fixed periods at varying rates of interest: all these increase the balance with which the banker closed the previous day

On the credit side of his finance book, the foreign or colonial banker will have the total of his fixed deposits maturing on the day; bills payable and bills on which the bank is liable as acceptor falling due to be paid; total

of telegraphic transfers to be paid; amounts to be paid on maturing contracts for purchases of gold and silver coin or bullion; total sum payable for outward bills purchased or advanced against (i.e. exporters' bills drawn with documents attached for shipments to foreign or colonial centres in which the bank has branches or agencies); bills drawn under letters of credit issued by the bank's foreign branches, etc.

The difference between the two sides represents the amount on which the banker has to work. If he has a balance on the debit side, he knows he can afford to lend money out on the market at call or short notice; if the balance is on the credit side, it is the other way about, and the banker may have to sell bills under discount, or he may himself borrow on the open market from the clearing banks, or from the money brokers who have surpluses to lend.

"Balance Purposes."

The finance book of the manager of the joint stock bank will be on a similar basis. He starts with his overnight balances at the Bank of England and his other London correspondents. To these are added the proceeds of all documents, cheques, bills, etc., in course of collection, and those maturing on the day in question; these will increase his balance considerably. "Against these, he has to provide for bills payable at the bank, for payments intimated as having to be made on behalf of customers and others, and for transfers of money on behalf of branches or customers."[1] In this case, too, the net balance represents the sum upon which he can work for the day If the difference between the two sides shows, say, £750,000 to the good, and the banker requires only £250,000 for balance purposes, he knows that he has in hand £500,000 surplus for employment on the London market. By "Balance Purposes" is meant "the sum that by arrangement is

[1] *Cf. The London Money Market* (p. 9), by Geo J Scott

kept with the Bank of England and other London correspondents as a balance for working the accounts plus a margin for the fluctuations that occur during the day's transactions."[1]

The manager of a London joint stock bank is in rather a better position than the manager of a foreign or colonial bank; the latter often has unforeseen demands sprung upon him from abroad, the first intimation he gets being a telegram saying that drawings for a considerable sum are being made upon him during the day; but a joint stock bank manager usually knows approximately what his requirements are likely to be for the next week or ten days, consequently, unlike the foreign banker, he is in a position to know whether he may lend money to the market at call or short notice, or whether for a week or even longer.

With a foreign or colonial bank, the brokers generally have only one loan running; why, it is difficult to say, it is a custom which seems to have grown up with the market and remained. With the other joint stock banks it is customary for each of the brokers to have five or six loans running with the same bank for varying periods and varying maturities. If, then, the London banker has a surplus, he has to consider to which of the brokers he will make an additional loan. "Institutions of the size of the Scotch banks lend their money in amounts of about £25,000; that, however, depends altogether upon the amount of money to be lent out, and on the number of borrowers available. If there is any difficulty in lending the money, that is to say if the discount market is well supplied with funds, the banker will be only too glad to increase the figure which he lends to the broker to £50,000 or even £100,000; but when the amount is large, he usually endeavours to fix it in amounts of, say, £25,000 each over various dates within the next six to ten days."[1] As a matter of fact, seven days is the more usual period.

[1] *Cf The London Money Market* (p. 9), op cit

Day-to-Day Business in Loans.

The foreign and colonial banks, in view of the peculiar nature of their business, generally prefer to lend their money out from day to day, and the amounts range from £50,000 upwards. Apart from this day-to-day money, all the banks lend money to help brokers over from one day to the next when they are "short" on their book. This emergency money, or, as the market terms it, "night" or "bad" money, in some cases has to be repaid the next morning without further notice; in other cases, it is understood that the banks have the right to call it the next morning if desired, hence the brokers' description of it as "night" or "bad" money. Some money market operators do not like this class of loan very much, though it is often useful to brokers to carry them over a period of shortness up to twenty-four hours. Some of the large discount houses, too, tend to specialize in "night" money, and in so doing perform a useful function by relieving the banks of surplus funds that would otherwise be unproductive.

Overnight and day-to-day money is frequently lent at rates lower than that charged for weekly loans, or "weekly fixtures," as the market terms them. For example, when these lines were being written, overnight and day-to-day money was quoted at 1¼ to 1 per cent, while seven-day loans were quoted at 2 per cent. Sometimes the margin between the two classes of loan is much wider and the charge for weekly loans much more onerous. The rate for weekly loans does not vary much at different banks; in fact, the tendency is for all to quote a more or less uniform rate; but with the day-to-day and overnight loans it is customary for each lender to get the best rate he can.

Market Loans.

All the brokers are regular visitants at the banks for the purpose of finding out which are lenders and which are calling in money, which are buyers of bills and which are not; and arrangements for accommodation are frequently

made during these visits. In addition to this, however, constant use is made of the telephone. For instance, suppose money is in fair supply towards the end of an afternoon Adam Black, the banker, will possibly ring up Charles Dope, the broker, and ask the question, "Do you want any money?", and if the broker is a likely borrower, there will be the usual haggling over terms and business may or may not result If Charles Dope is not a borrower, or will not toe the line in the matter of rates, the banker will ring up, say, Edgar Fanecourt, and try him, and sooner or later the money passes from lender to borrower. Naturally, there are times when money is unlendable at any price, and it is then called "A drug in the market."

Now, suppose the boot is on the other foot and, owing to heavy demands upon him, the banker finds there is a possibility of his ending the day with his balance on the wrong side of the book. He will then proceed to call in his day-to-day money, and, if any weekly loans are due, he will not renew them. In such an extremity, the poor broker has to make constant use of the telephone, or has to rush round to find out who is a lender. Ultimately, he may be working on one of those days when practically all the bankers are calling in funds from the market, and so keen is the demand for money that he has no alternative but to go to the Bank of England for help The market is then "in the Bank"—a position we have described in previous chapters—and it is a state of affairs the brokers try their best to avoid, for, as the terms exacted by the Bank of England are much more expensive than those of the banks in the open market, the discount broker is shorn of a heavy proportion of his profit.

When discount brokers and others are forced to go to the Bank of England for accommodation it indicates that the creation of credit by the bankers has been extended to the utmost limit to which they think it prudent to go, considering the circumstances and the time.

"Floaters" and "Terminals."

For their loans made to discount brokers and others, bankers, of course, require the deposit of security. Cynics have remarked that a discount broker's capital consists of a pair of boots and a bill case—a remark that, like most of its kind, is pure nonsense. The broker may not need a large cash capital, but he undoubtedly must be possessed of a fairly large capital in the shape of short term gilt-edged bearer securities, such as Treasury bills. These securities so frequently change hands that they are known as "floaters" (they float about the market). Others are called "terminals," that is securities with only a short period to run before they fall due to be repaid, and among this class are Treasury Bonds, or similar short-dated bonds; but not more than about 10 to 15 per cent of such security is taken. The lender against such security knows that, if for any reason the borrower was unable to redeem his loan when called upon to do so, the bonds would not have to be held very long before repayment could be obtained. As a matter of fact, this is a contingency which rarely arises It is only in such unfortunate occurrences as bankruptcy that a banker gets left with the security on his hands and, as he always has a fair margin between the value represented by the stock and the amount of his loan, losses are almost unknown The bulk of the security against which the London joint stock banks and the Scotch banks make advances to the bill brokers consists of Treasury bills and first-class acceptances, the majority of the latter bills bearing the names of bankers as acceptors or endorsers. As the foreign and colonial banks are the places from which most of such bills emanate, they themselves usually lend only against "floaters" and "terminals."

When a banker is lending, he either gives the broker his cheque drawn on the Bank of England or lets the broker draw a cheque on him and receives in exchange a parcel of securities or bills; if a loan is called in, the broker hands the lending banker his cheque on his own banker, and

receives back his security. Frequently, as we have mentioned before, one banker will be lending and another will be calling, so, when the broker receives back his packet of securities, he promptly pledges it to another banker against an advance, and so it goes on, day in and day out. As one of the bankers himself has said: "It is a matter of considerable surprise to the uninitiated to watch how easily these sums, which total huge amounts, are rearranged from day to day; and when large financial operations are taking place either for the Government or for others, the displacement of money is enormous, and gives rise to a great deal of rearrangement on the part of the banks and the brokers."[1]

In this connection, attention may be drawn to a useful paragraph which appeared in the *Economist*, on January 1, 1938. For the purposes of record that paper gave a table of annual averages of short loan and discount rates over the previous nine years In interpreting the rates, however, it was stated that a sharp distinction should be drawn between the earlier and later years, and for this reason. During the past few years both short loan and discount rates had been pegged within fairly narrow limits, mainly, as the Editor rightly stated, through co-operation between the Clearing Banks There had thus been developed a controlled market in place of a free market. The following was the table published—

AVERAGE MONEY RATES

Year	Bank Rate			Market Rate 3 Months' Bills			London Deposit Rate, Banks			Short Loans		
	£	s	d	£	s	d	£	s	d	£	s	d
1929	5	10	0	5	5	4	3	10	0	4	12	3
1930	3	8	5	2	12	3	1	8	5	2	9	6
1931	3	18	7	3	11	0	2	1	0	3	0	10
1932	3	0	2	1	16	9	1	5	2	1	15	7
1933	2	0	0	0	13	10	0	10	0	0	15	5
1934	2	0	0	0	16	7	0	10	0	0	16	10
1935	2	0	0	0	11	3½	0	10	0	0	14	10½
1936	2	0	0	0	11	10½	0	10	0	0	15	6
1937	2	0	0	0	11	6½	0	10	0	0	15	1½

[1] Mr. G J Scott.

To illustrate the distinction, the *Economist* showed that for about two years the Clearing Banks had as a rule lent money at fixed rates of $\frac{1}{2}$, $\frac{3}{4}$, and 1 per cent, the rate depending on the collateral lodged against each loan. "Other banks and financial houses known as 'outside lenders,' vary their rates at will, but a common rate is $\frac{1}{2}$ per cent for loans against bills, and $\frac{5}{8}$ per cent for loans against bonds Thus the effective average rate for loans against bills has lately been $\frac{1}{2}$ per cent. As regards discount rates, the Clearing Banks have agreed to buy Treasury bills at not less than $\frac{1}{2}$ per cent, and during most of the year their minimum rate was also the actual rate at which the bulk of the Treasury bills were bought and sold. Three months' bank bills were dealt in more freely—in practice at rates just above the Treasury bill rate. These considerations explain the apparent anomaly in the table of the short loan rate being higher than the market rate for three months' bank bills. This phenomenon has been apparent ever since 1933; it arises directly out of the fact that the market rate of discount on Treasury bills has fallen far below the rates to be obtained on bonds and other securities. The actual rate for short loans against bank bills was $\frac{1}{2}$ per cent, compared with an average market rate of just over $\frac{17}{32}$ per cent. Thus bill brokers had a very small margin of profit." [1]

Banks' Assistance to Trade.

At this point it will be useful to see whence the bills originate with which the brokers and bankers deal. Those circulating on the London discount market chiefly enter England from other countries, and they arise in this manner. At every foreign centre there will be found merchants and others ready to export their produce and manufactures, and to facilitate their operations the assistance of the bankers abroad is in constant request. The

[1] *Economist*, p. 29, January, 1938

London branches of the foreign and colonial banks, for their part, will have been instrumental in assisting exporters in England by purchasing or advancing on their bills drawn on identical foreign centres. These bills the bankers send to their foreign branches, and the latter present them for acceptance or payment, as the case may be, and in due course receive the money. The funds the bankers thus receive abroad from the encashment of the drafts sent from London are utilized for purchasing bills offered for sale at the foreign cities drawn on London.

In brief, the exporters obtain payment for their produce and manufactures by drawing bills of exchange on London, in the same way as the shippers from London draw on foreign countries, and the net result of the various operations is the influx of bills of exchange into England for ultimate circulation on the London discount market.

Bills of exchange arising out of imports and exports are not the only ones with which the London discount market has to deal. On every financial centre there will always be a number of people drawing bills of exchange for services rendered or debts due, while others will be purchasing bills of exchange for the purpose of sending them to their creditors in settlement of debts and for other purposes. In the circumstances, many clean bills, that is bills without documents in any shape or form, being attached, will be drawn and sent to London, where they will ultimately be disposed of on the market.

To this total of documentary and other foreign bills coming on to the London market has to be added a large number of bills which have been drawn on and accepted by the London accepting houses, and the London branches of Indian, colonial, and foreign banks in connection with various financial and commercial transactions. There is also a fairly large number of bills of exchange arising from the inland or domestic trade of the country.

These all form the principal bills with which the bill broker is concerned in his efforts to meet the investment

demand for such securities from banks and other operators on the London market.[1]

Bank Paper.

For practical discount purposes, the market divides the bills into two great classes—Bank Paper and Fine Trade Paper. Bank paper comprises all those bills drawn on and accepted by the great joint stock banks and finance houses, also those drawn on and accepted by the London offices of our large Indian and colonial banks; and it does not matter whether the bills emanate from abroad, or whether they are simply drawn, accepted, and paid in London—they all represent bank paper, provided the acceptors are domiciled, and have their Head Offices in London. The point is this, Bank paper comprises either Bank acceptances, or to stretch a point, paper, Bank endorsed.

Fine Trade Paper.

Fine trade, or "white" paper, includes all commercial bills drawn and accepted by first class merchants and traders.

The expression "clean bill" is sometimes heard on the London market. The general criterion of "clean" bills as far as the Bank of England is concerned is that they should bear on their face evidence of their being drawn against specific shipment of commodities or some definite security. Fine trade bills without such particulars are apt to be regarded with suspicion. They are not really undiscountable; but, especially in abnormal times, the discount market exercises a wide discretion, will only take a proportion of the bills bearing well-known names, even with a banker's endorsement, and tends to look upon the paper as akin to accommodation bills of the

[1] For a full discussion on the various classes of bills and how they arise, the reader is referred to *Foreign Exchange and Foreign Bills in Theory and in Practice* by W. F. Spalding (Sir Isaac Pitman & Sons, Ltd.)

"pig on pork" and "pork on pig" variety—a curious expression which the market gives to bills which are drawn between two branches of the same firm, or by one person or firm on another, intimately connected, for the obvious purpose of raising funds

It might be noted here, that the Discount Market does not deal with what are called "Documentary Bills," i e. bills of exchange with shipping documents attached. All the bills are "clean"—and those that have not been drawn clean in the first instance, have ultimately become so, by reason of the documents having been delivered on acceptance of the bill

Rates for Discounting.

Bank bills are always discountable at best rates, and the market always has the right to a higher discount deduction for fine trade paper. For instance, at the time this chapter was written, for three months' bank bills the rate was from $2\frac{1}{16}$ to 2 [illegible] per cent, but for fine trade bills it was about 1 per cent higher—3 to $3\frac{1}{2}$ per cent. Generally speaking, the rate for this class of bill is anything from $\frac{1}{4}$ per cent to 1 per cent over Bank Rate, according to the state of the market. Branches in London of the large foreign and colonial banks, and other houses of undoubted prestige, can usually get their bills discounted at slightly over the discount rate for bank paper, and, in normal times, even at the same rate as for bank paper: it is all a question of keen bargaining, and there is often a good deal of give-and-take in the matter of rates.

In some quarters there is, however, a tendency to differentiate between bank paper, and to make two classes, viz Fine Bank Paper and Bank Paper: the former consisting of acceptances of the first-class London joint stock banks, and the latter the acceptances of the Indian and colonial banks, whose head offices are domiciled in London. Here, again, the guiding rule adopted by the Bank of England is: Has the bank the greater part

of its assets in London or abroad? It is perhaps unnecessary to add that if the assets are small, the paper is not "fine"—for as Bank Paper also implies "fineness," bills likely to fall far short of that adjective are rigidly excluded.

The difference between bank bills and fine bank bills is a little difficult to define. The distinction is noticeable not so much in the rates quoted as in the preference for one bank's paper over that of another.

Three months' bills are most in demand on the London market, for the reason that the banks and other finance houses who carry this class of investment find it practicable not to tie up too large a proportion of their money for longer periods. Three months' paper is, therefore, regarded as the ideal paper for discount purposes and, as a rule, bills at about that usance are not difficult to place

There is no definite ratio between the rates quoted for three months' bills and those quoted for four and six months' bills With the longer-dated paper, the question of longer credit enters into the calculation, and rates paid will depend largely upon the probable trend of the market and the standing of the persons whose names appear on the bills.

Bill Brokers' Methods.

Let us return to the bill brokers. Here the difference between the various classes should be noted We have the "running" brokers, who are a class apart They act purely as brokers, and do not, as a rule, guarantee payment of bills: they act purely in the interests of the people employing them. There are also the discount brokers and discount houses; these both buy and sell bills, and when selling guarantee the due payment of the bills. In order to be in a position to make or invite definite offers for any of these bills, it is necessary for these discount people, whom we will call brokers for convenience, to visit daily the offices of those who have the paper for sale, namely, the London offices of the colonial, Indian, and

foreign banks The brokers make several visits to these banks in the course of a day, but their first call is usually paid between 10 and 11 a.m. On entry into the manager's private sanctum, a broker will report on the likely tone of the discount market; and if the colonial, Indian, or foreign banker has any bills to be sold under discount, he will hand the broker lists which give the class, amount, and maturities of the bills With these in his hands, the bill broker then proceeds to the offices of his other clients, the London joint stock banks, finance houses, and Continental bankers, and will there endeavour to negotiate business.

Now, while bills drawn at three months' date or sight are the most favoured by the bankers, because owing to the competition of Treasury bills that is the actual usance of bills in practice, yet bills at four and six months are also, as a rule, readily discountable on the market by the discount brokers or discount houses. At one time brokers were able to dispose of mixed parcels of bills, and in that case discounters used to stipulate for an assortment of acceptances. That is to say they required a proportion to mature at three, four, and six months date. Nowadays, however, it is customary for the discount brokers to discount each usance in separate lots.

Joint stock bankers find it desirable to purchase three months bills, and they confine their purchases to this "Short" paper, except on very exceptional occasions. The reason is that it is convenient for bills to fall due at precisely those periods at which a banker has to replenish his treasury in readiness for cash demands. All London bankers have come to know by experience the probable dates at which calls will be made upon their cash balances and, unless anything untoward happens, they can so arrange that payments are made in accordance with their requirements. As we have previously remarked, if they want money they refrain from buying further bills from the discount market, and simply let the contents of their

bill portfolios run out. When they have again a surplus of cash further investments in bills may be made.

It might be thought that, if a banker wanted cash immediately available, it would be easy for him to re-sell the contents of his portfolio. In practice, however, banks rarely, if ever, re-sell the bills they have bought under discount. There is no particular reason why a bank should refrain; but, as the matter stands, it seems to be considered *infra dignitatem* for a banker, once he has acquired a bill from the discount market, to offer it again for sale.

In this bill business it does not follow that the colonial, Indian, or foreign branch banks will sell all their bills Sometimes, owing to their having surplus funds, and no particular business in sight in which to employ their money, they may consider it expedient to retain some of their bills, especially if rates are not considered suitable. They can always sell the bills at a later date if desirable. For instance, the joint stock bankers are often seekers after bills with shorter periods than three months to run. In that case, business can usually be negotiated through the intermediary of the bill broker, and the holders of paper will sell bills under discount with only a month or two to run. The rates, then, are a matter of arrangement with the buyers, who here, again, will time the maturity of their purchases to coincide more or less with the dates on which they want the money available Towards the end of March, for example, there is frequently a demand for bills maturing about the second or third week in June; similarly, in October, the banks are nearly always buyers for bills to mature just before the close of the year; at both periods the bills run out at about the time the banks require surplus cash

There is also another usance of bank paper which is greatly in favour with joint stock bankers and others, we refer to sixty days' bank bills The rate for these is usually about the same as for three months' bills, though

sometimes it is even slightly higher and sometimes slightly lower; for example, on November 22, 1932, three months' bills were quoted at $\frac{7}{8}$ to $\frac{15}{16}$ per cent discount, but for sixty days' bank bills the rate was $\frac{3}{4}$ to $\frac{13}{16}$ per cent. Here, again, it is *all a question of demand; generally speaking*, the supply is never excessive and if, as often happens, discounters are eager buyers, the latter class of paper will fetch a price a shade over the rate for three months' bills, that is to say, they are discounted at a lower rate.

The bills that pass through a broker's hands on the London market are legion, and sometimes, if the joint stock bankers are not buying, he may be obliged temporarily to carry large wads of the paper himself, since, theoretically, the broker is supposed to take all good bills offered to him or, what amounts to the same thing, to find purchasers for them, and in practice he rarely declines to do business for his clients.

The "Middleman" in Discounting.

The mere utterance of the word "middleman" is, nowadays, anathema to some people, yet, in this particular business before us, we have an example of the truly valuable services a middleman may sometimes perform. In the money and discount markets, as we have seen, the economic division of labour is carried out to perfection; and the reason the banker prefers to deal through the intermediary of the bill broker is that he is a specialist in the business, and, as is so often said on the market, what the London bill broker does not know about the various classes of bills, and those whose names appear on them, is not worth knowing. In fact, owing to his intimate knowledge of the parties to a bill, the broker is able to guarantee the genuineness of all acceptances discounted; and, although his name does not appear on the bills, yet it is his business to see that all acceptances passing through *his hands bear the indorsement of the bankers and others* disposing of them, and that they are otherwise in order.

Further, the broker undertakes to endorse a bill if it is unpaid, i.e. he guarantees payment.

There is another point From his constant contact with the market, the bill broker knows the position and financial means of the drawers, acceptors, and endorsers of bills of exchange. Further, in his daily rounds he gets to know the proportion of the bills of each firm that are current on the market, and more than one banker has had cause to thank the bill broker for a timely warning to act cautiously when both drawers and acceptors appear to be out-running the constable. It is comparatively easy when dealing with a bill broker for bankers to refuse bills bearing the names of persons about whose credit there is doubt, or of whose bills they consider they have a sufficient amount in portfolio; but, if the bankers were dealing direct, it would not be so simple to decline to accommodate regular clients

When a broker has arranged a purchase of bills, the holder of the acceptances simply transfers his title by endorsement, and hands the bills over to the broker against payment of the agreed price The joint stock banks, or other discounters, do not take bills without the endorsement of the Indian, colonial, or foreign branch bank that is the seller. The practice of the Bank of England is to stipulate for the names of two British firms, one of which must be that of the acceptor, domiciled in London, upon all paper that it discounts.

Incidentally, as the bills bear the endorsement of a banker, those who discount them have recourse on that endorser in the event of non-payment at maturity, and that is one reason why bills pass so freely on the market and are discounted at comparatively moderate rates

As we have mentioned earlier, the majority of bills discounted on the London market are those which have been drawn by exporters abroad on British importers or bankers, the acceptors being either the importers or banks and finance houses who have arranged to accept the bills in London in these circumstances on account of the

importers. It is thus fairly easy to get at the responsible parties if anything is wrong, such as refusal to pay at maturity, or anything of that sort. There are, however, two classes of bills which are often found among those that arrive by each mail which are questionable for discount purposes. We refer to bills termed "foreign domiciles" and "foreign agencies."

Foreign Domicile Bills.

A foreign domicile bill arises in this manner. In foreign or colonial centres there are shippers other than British, whose bills are passed through the exchange banks. A French or Italian exporter, for instance, may draw bills against his produce, and the banks at the shipping centre will negotiate the bills on the understanding that they are to be accepted "payable in London." On arrival in London, the bills will be sent for acceptance, say, to Paris or to Milan, the persons upon whom they are drawn will accept them in the cities mentioned, but will make them payable at some bank in London; and when the bills are completed by acceptance, they will be returned to London to the branch of the bank which negotiated them abroad. This paper, bearing the acceptance of continental firms and others, is not liked on the London market, and neither the joint stock banks nor the finance houses care to carry it in their portfolios in ordinary times. In fact, during the War, and afterwards, foreign domiciles became undiscountable on the London discount market; consequently, foreign and colonial banks which receive them are practically obliged to retain the bills until maturity and, if the paper is in any quantity, this means a bad lock up of funds for the banks whose foreign branches have been induced to negotiate them.

Prior to the War a small proportion of foreign domiciles was taken in parcels of bills discounted by some of the finance houses; some were also taken by the discount brokers; but in all cases the persons disposing of them

had to pay higher rates to discounters who elected to receive the paper.

The Bank of England has always steadfastly set its face against these bills, and never would discount them in any shape or form, not even when endorsed by first-class colonial and foreign banks in London.

This discrimination against foreign domicile bills has led the discount market to take other steps to maintain the high prestige to which the "bill on London" has risen, and it has extended the ban, though in a less severe way, to those bills which it terms "foreign agencies"

Foreign Agency Bills.

Foreign Agencies are bills accepted by the London branches and agencies of foreign banks or firms who are established in London, but have the greater part of their assets in foreign centres. It seems to be considered that the assets of these concerns cannot be made available in the event of bills being dishonoured. As the result of this discrimination, foreign agency bills are discountable to a limited extent only, and those selling the paper are penalized in the matter of rates, the charges being from $\frac{1}{16}$ to $\frac{1}{8}$ per cent higher than those for first-class English domicile bills.

The Bank of England will not discount foreign agency bills.

At this point we may refer to another item of interest in connection with bills Any one entering a bank in the City will observe a notice "Rebate Rate .. %" The rate marked up is usually $\frac{1}{2}$ per cent above the advertised rate of interest allowed by the joint stock banks for short deposits, and the information is for the benefit of those acceptors who may wish to retire their bills before maturity. Here, again, to avoid confusion, a little explanation is necessary.

Bills drawn and accepted in connection with overseas trade may be roughly divided into two classes. "D/A" bills and "D/P" bills Let us take the D/P bills first

"Documents on Payment" Bills.

As the reader will probably surmise, they include those bills bearing the clause "Documents on Payment." The clause may be written on the bill itself or, as sometimes happens, it may be written on a slip attached to the bill. The effect of such a clause is that the person upon whom the bill is drawn, notwithstanding the fact that he has accepted the bill in the usual way, cannot obtain the documents of title to the goods or securities represented by the bill until he pays it. Such a bill, obviously, is not good for discount purposes, and the banker who has it is, therefore, obliged to hold it either until maturity, or until the acceptor retires the bill under rebate at the rate to which we have just referred. It is not exactly a matter of caprice whether the acceptor of a D/P bill pays it one day after acceptance, or whether he lets the bill run its full term, it all depends upon whether he can sell the goods against which the bill is drawn promptly, or whether he can raise the money to take up the bill in some other way. If he has the chance to make a quick sale, or is able to get the money to pay the bill, the acceptor will probably be only too glad to pay the bill, less the rebate at the rate allowed by the banker for such payments. This rate, as we have said, is ½ per cent above that allowed by the joint stock bankers for short deposits, so the concession is attractive enough to induce the acceptor to retire the bill if in any way possible.

"Documents on Acceptance" Bills.

Then there is the "D/A" bill. The mystic letters D/A simply mean, "Documents on Acceptance." Such bills are generally drawn on better class firms than those upon which D/P bills are drawn. In this case, the banker through whom such a bill is passed presents it for acceptance, and immediately it is completed by acceptance the documents of title attached to the bill are promptly delivered to the acceptor. Now, the banker to whom the

bill is returned may or may not desire to keep it in his portfolio until maturity. If he is one of the exchange bankers, the probability is that he may desire to sell it under discount on the London market. On the assumption that the banker does sell the bill to the discount market, what is to happen if the acceptor comes along later and desires to pay the bill before maturity? On the face of it, the banker is in a quandary; having sold the bill, he might as well hunt for the proverbial needle in a haystack as to try to trace the bill on the market. Let it be said at once that there is no obligation upon him to produce the bill before maturity, but these bankers in practice are accommodating men and are willing to help acceptors all they can. What the banker does in such circumstances is to allow the acceptor to pay the amount of the bill, less discount for the unexpired time at about the ruling rate for discounting bills of the class applicable to the one the acceptor desires to pay. The rate of discount allowed, it should be noted, is not the same as the rebate allowed on a D/P bill; it is always a matter of agreement between the banker and acceptor. When the rate of discount is arranged to the greater or less satisfaction of both parties, the banker receives the cash, and, as he cannot produce the bill, he does the next best thing and hands over to the acceptor a letter of guarantee, somewhat on the following lines—

BANK OF GOODWILL

LONDON,

April 1, 1938

To Haydn Ash, Esq
Thames Street, E C 2

Dear Sir,—

Your Acceptance for £500—due June 2, 1938

In consideration of your having retired the above-mentioned acceptance under discount the bill not being in our possession, we hereby undertake to hand to you on the due date our cheque for the full amount required to meet this acceptance

Yours faithfully,
C D E,
Manager

Forward Discounting.

Before leaving this subject of the discounting of bills of exchange there is one other operation to which we may refer—Forward Discounting. Forward discounting is not very frequently witnessed by the average man, and rates for forward discount are rarely seen in the money article of the newspaper. As in so many other operations on the London Money Market, it is all a matter of arrangement between those who have, or know that they will have, bills for sale, and those who desire to have them by a certain date. The business arises in this way.

A foreign or colonial banker is usually well and promptly advised by his overseas branches of the amount and the class of bills on the way. With their extensive telegraphic codes, it is a matter of comparative ease for the foreign branch to let the London branch know the approximate amount of bills coming forward, their usance, and the categories under which they fall. A specimen telegram, when de-coded, might read—

Have negotiated and mailed to you to-day £300,000 three months' bills, and £100,000 four months' bills All on first-class names No foreign domiciles or foreign agencies included

With this information in its hands, the London branch of the bank, through the intermediary of its discount broker, can arrange to get a parcel of bills discounted "to arrive" The rate is always a matter of negotiation, but, generally speaking, those who buy such bills are guided by the time expected to elapse before the receipt of the bills and the tone of the discount market. Different rates are fixed for each class of paper and each maturity, one rate for bank paper, and another rate for fine trade bills Separate quotations will be given for three, four, or six months' date bills in each category. The basis for the quotation is the rate ruling in London for each class on the day the offer is made, and business is ordinarily settled near to the existing quotations.

As there is a good deal of adjustment to be made on the

arrival of a batch of bills which have been sold forward, some bankers and discounters are apt to regard the business as rather a nuisance, but it works well in practice, though, naturally, the element of speculation inherent in it may not commend itself to a prudent and conservative banker. For instance, if when the bills arrive the rate of discount be 4 per cent for three months' date bills, and the discounter has contracted to purchase them at 3 per cent, he is, nominally, a loser of 1 per cent on each £100 bill, that is to say if a bill had the full three months to run after acceptance, he would pay £99 5s. for it; but if he had waited and had purchased the bill at the rate ruling on arrival, 4 per cent, he would have got it for £99. His loss, of course, would have been the seller's gain. The position, however, might very well be the reverse, and the discounter be a gainer instead of a loser.

There remains the question of Treasury bills, with vhich every diligent student of the money article will be iore or less familiar; and, in view of the importance of is particular instrument, it will be well to devote our ext chapter to a consideration of the Treasury bills now i circulation on the London market

The chart inset will give the reader a very clear insight to the variations in discount rates for the year 1931, and ll serve as a useful aid to those who are industrious enough trace the connection between discount rates and the movements in the figures of the Bank of England Return.

The Chart is of historical importance as indicating in a convenient form the events antecedent and subsequent to the departure of Great Britain from the Gold Standard.

CHAPTER IX

PRINCIPALLY ON TREASURY BILLS

TREASURY Bills are an ideal class of short term investment security for bankers, particularly when they take the form of bills having a usance of three months. Where a government like the British Government issues them, a purchaser has not to worry about whether they will be met at maturity; he knows that when the term for which they are drawn has expired he simply has to present the bills to the Bank of England, when he will receive his money.

There is no bother about acceptance or endorsement (unless the bills are drawn "to order" or a name is inserted in the space provided on the bill); and as the bills bear no names except that of the Secretary to the Treasury, a banker, if he so desires, can always dispose of them without comment being made by the market.

Origin of Treasury Bills.

The origin of Treasury Bills dates back to 1877, and the credit for the invention is due to the late Walter Bagehot, the famous editor of the *Economist*. Just how Bagehot came to be identified with them was described some years ago by Lord Welby in a letter to the *Economist*.

It appears that in the seventies, under the authority of Parliament, an extensive system of loans had been made to education and sanitary authorities from the Exchequer; and so great were the inroads made into the Exchequer balances, that, in 1877, the Chancellor of the Exchequer, Sir Stafford Northcote, found himself faced with the necessity for providing further funds to meet the ever-increasing demands. He was averse from adding to the permanent debt of the country in Consols; consequently, the only alternative was to increase the floating debt by issuing some form of short-dated security. The floating debt at that time was chiefly in the form of Exchequer bills, but

these securities were out of favour with the public, who preferred to invest their money in railways and other industrial undertakings, which at that period were offering excellent investments giving a good return

Credit of British Treasury.

Sir Stafford Northcote had great confidence in the knowledge and judgment of the great editor of the *Economist*, so he directed one of his Ministers to lay the case before Bagehot, with a request for his advice on the subject. This was done, and Bagehot, with characteristic thoroughness, was prompt in his solution of the dilemma. He wrote—

"The English Treasury has the finest credit in the world, and it must learn to use it to the best advantage A security resembling as nearly as possible a commercial bill of exchange—that is a bill issued under discount, and falling due at certain intervals—would probably be received with favour by the money market, and would command good terms."

Sir Stafford Northcote accepted Bagehot's recommendation and, probably in conjunction with him, devised the floating security with which the London Money Market is so familiar at the present day—Treasury Bills. The device has since been copied by many other nations in the world, which in itself is a magnificent tribute to the sagacity of Bagehot's advice.

When these bills were first issued they were readily taken by the market, and they have held the field ever since. As Lord Welby pointed out in his letter to the *Economist*, there is always competition for them, and they therefore realize favourable prices to the British Treasury. They are economical because the amount outstanding can be increased or decreased in close conformity with the needs of the Treasury. That they have stood the strain of more than one war and emergency everyone will agree.[1]

[1] *Cf.* Letter from Lord Welby to the *Economist*, November 17, 1909.

Specimen Treasury Bill.

The following is a specimen of the Treasury Bills now in use—

Due April 17, 19—.

TREASURY BILL
Per Acts 40 Vic c. 2 & 52 Vic. c. 6.

B.

£5,000. *No ....*

London,
January 17, 19—.

This Treasury Bill entitles[1] . . . . *or order to payment of Five thousand pounds at the Bank of England out of the Consolidated Fund of the United Kingdom on the 17th day of April, 19—*

(Signed) . . . .
Secretary to the Treasury.

Tenders for Treasury Bills.

Treasury Bills now, as they were before the War, are sold by tender. When they are on offer, an advertisement appears in the *London Gazette* to the effect that a certain specified amount is for sale, and the bills are allotted to those applicants who tender at the lowest rate of discount. The announcement in the *London Gazette* is usually in the following terms—

TENDERS FOR TREASURY BILLS

The Lords Commissioners of His Majesty's Treasury hereby give notice that Tenders will be received at the Chief Cashier's Office, at the Bank of England, on Friday, March 17, 19—, at 1 o'clock, for Treasury Bills to the amount of £50,000,000.

The Bills will be in amounts of £5,000 or £10,000. They will be dated on any business day from Monday, the March 20, 19—, to Saturday, March 25, 19—, inclusive, and will be payable at three months after date.

[1] If this blank be not filled in, the Bill will be paid to bearer.

The Bills will be issued and paid at the Bank of England.

Each Tender must be for an amount not less than £50,000, and must specify the date on which the Bills required are to be dated and the net amount per cent (being an even multiple of one penny) which will be given for the amount applied for. Separate tenders must be lodged for Bills of different dates.

Tenders must be made through a London banker, discount house, or broker.

The persons whose Tenders are accepted will be informed of the same not later than the following day, and payment in full of the amounts of the accepted Tenders must be made to the Bank of England by means of cash or a banker's draft on the Bank of England not later than 2 o'clock (Saturday, 12 o'clock) on the day on which the relative Bills are to be dated.

In virtue of the provisions of Section 1 (4) of the War Loan Act, 1919, Members of the House of Commons are not precluded from tendering for these Bills.

Tenders must be made on the printed forms, which may be obtained from the Chief Cashier's Office, Bank of England.

The Lords Commissioners of His Majesty's Treasury reserve the right of rejecting any Tenders.

Sale at Fixed Rates.

On April 13, 1915, the British Treasury departed from the old system of offering Treasury Bills by tender, and put them on sale through the Bank of England at fixed rates for various usances, namely, three, six, and nine months. In the first instance, the rates published by the Treasury were: For three months' bills, $2\frac{3}{4}$ per cent, six months' bills, $3\frac{5}{8}$ per cent; nine months' bills, $3\frac{3}{4}$ per cent. On May 8, 1915, bills* at twelve months' date were added, the rate of discount being $3\frac{3}{4}$ per cent When the bills were first issued, the public were notified that the Government reserved to itself the right to vary the rates, whenever it was considered advisable, without previous notice to the market. As a matter of fact, the rates were altered considerably from time to time, but they were always promptly notified to applicants at the Bank of

England, and the Press was quick to notice any changes. Market conditions had a good deal to do with the variations, but, in a lesser degree, perhaps, they were necessary to enable the Treasury the better to regulate the inflow of money in order to meet its urgent requirements.

The system of fixed rates, undoubtedly, was a convenience, because applicants were enabled to know the exact rate of discount before making purchases. Prior to the War, the business in these Treasury Bills had been almost exclusively confined to the banks and discount houses, but the new system of sales at advertised rates gave the general public an appetite for the investment. The short-term character of the bills made them a convenient and popular investment for outside institutions and persons who desired some investment the repayment of which would coincide with the date on which it was necessary for them to have funds in hand Instead of letting the money lie idle on current account at their banks, they had a good opportunity of putting it out at satisfactory rates of interest. Then, as we have seen so many times in the course of our study, banks, financial houses, and even the ordinary investors, like to know that they have money coming available at definite dates in the near future.

Competition with Other Bills.

But the system of sales at fixed rates, however convenient it may have been to the Government, was not without its disadvantages to the open market, where other bills had to be bought and sold. As the present author wrote elsewhere at the time they were first issued,[1] the presence of Treasury Bills on the London discount market necessarily affected the price of all other bills sold under discount It had a twofold effect. In the first place, the purchases of Treasury Bills were responsible for the investment of an enormous amount of floating money. In fact,

[1] *Foreign Exchange and Foreign Bills in Theory and in Practice* (p. 301), by W. F. Spalding. (Sir Isaac Pitman & Sons, Ltd)

on April 9, 1921, the amount of the bills outstanding was £1,115,812,000. Consequently, these purchases tended to absorb the excess supply of floating money on the market, and kept bankers' rates for money at call, at short notice, and for longer periods at much higher levels than would otherwise have been the case. Then, again, it affected the discount rates for bank and, in a lesser degree, that for fine trade bills. By force of circumstances the market found itself committed to rates for bank bills from which it was practically impossible to depart so long as the British Government's Treasury Bills were on offer at fixed rates of discount. With the longer-dated paper the market was not much concerned, but while the shorter usances for Treasury Bills were obtainable over the counter at the Bank of England at the advertised rates, the market was practically bound to offer similar rates of discount, as buyers were not likely to pay higher prices for bank bills than those at which they could purchase Treasury Bills, issued on the security of the Consolidated Fund of the British Government

Competition was not so severe with bills for shorter periods than three months, though, for a time, from July 14, 1919, to August 14, 1919, the Government actually sold two months' date Treasury Bills at 3⅜ per cent.

While the British Government's sales of Treasury Bills at fixed rates continued, the discount market was, to all intents and purposes, under the direct control of the Government; and the Government, through its agent, the Bank of England, kept in close touch with the situation right through the war years and controlled the situation down to April, 1921. The rates, the usance of bills, and the method of offering them were varied from time to time. Sometimes they were on sale at fixed prices, at other times the tender system was resumed; occasionally, both systems were operative at the same period, and an example of this "double" system was seen in April, 1917. On the 23rd of that month it was announced that, in addition to

the offers of bills by tender from time to time, applications would also be received from April 28, 1917, for a limited amount of Treasury Bills at advertised rates, these rates always being less than those in respect of bills sold by tender during the previous seven days. These bills were known as "Intermediate Treasury Bills." They were on offer until June 16, 1917.

Now and again a halt was made in the issue of Treasury Bills, chiefly for the purpose of facilitating subscriptions to war loans and similar issues, only to be started again as soon as the flotation of the loans was completed. Finally, on April 11, 1921, the Chancellor of the Exchequer announced in the House of Commons that the system of keeping Treasury Bills "on tap" at fixed rates at the Bank of England would be suspended, so far as three months' bills were concerned, as from April 21, 1921. From that date the practice of offering the bills by tender was resumed.

As we have shown, the amounts to be offered are announced in the Government organ, the *London Gazette*, each Friday. The tenders have to be handed in at the Bank of England on the following Friday before 1 p.m., and the banks, discount companies, or other approved financial houses, making offers must choose the day in the ensuing week from which the bills shall be dated, payment being made on that day. Tenders must be in pounds, shillings, and pence per £100, and in multiples of £5,000. As we have previously stated, no tender is accepted for an amount less than £50,000. Subsequently, the Treasury, in each week, may issue through the Bank of England what are known as "additional" Treasury Bills, that is, bills over and above the amount allotted as the result of the week's tenders. These bills are issued at a fixed rate, which is based upon the average rate of the successful tenders for the preceding Friday The discount rates for these "additional" bills is less than the rate at which bills have been allotted during the previous week.

For example, an allotment of £53,000,000 three months Treasury Bills was made on the March 24, at an average rate of discount of £3 2s. 6·30d., and immediately afterwards the rate for "additional" bills was fixed at 2⅞ per cent, making them 5s. 0·30d. per cent dearer than the Treasury bills issued as the result of the tenders. The rate for these "additional" bills is called by the market the "tap" rate.

Treasury Bills Issued Since 1914.

The following table will show the enormous increase in floating indebtedness of the British Government arising from the sales of Treasury bills on the London market since the commencement of the Great War in 1914—

TREASURY BILLS OUTSTANDING ON DECEMBER 31

Date	£000's	Date	£000's
1914	99,100[1]	1926	663,500
1915	380,181[2]	1927	650,750
1916	1,115,815	1928	787,985
1917	1,058,175	1929	780,245
1918	1,094,740	1930	690,235
1919	1,106,150	1931	664,180
1920	1,102,109	1932	928,250
1921	1,059,806	1933	938,745
1922	719,040	1934	899,710
1923	652,280	1935	865,920
1924	626,060	1936	766,195
1925	635,500		

[1] Approximate [2] As on December 25, 1915

The amount outstanding on December 31, 1914, was £99,100,000; and the amount outstanding on December 31, 1937, was £889,710,000, an increase of £790,610,000

With effect from March 17, 1922, the Treasury adopted the practice of offering for tender five-year Treasury bonds as well as three-months' bills. The total amount of bonds and bills to be offered was always stated; for instance, on November 30, 1923, it was announced that tenders would be received on December 7, 1923, for Treasury bonds and bills to be issued to the maximum amount of

£45,000,000, of which Treasury bonds to be issued would not exceed £4,000,000. The Treasury bonds first offered carried 5 per cent interest; those offering in December, 1923, were 4 per cent bonds. This system of offering five-year Treasury Bonds with Treasury Bills was finally discontinued in April, 1926. Nowadays, the weekly offering in three months bills is usually around £45,000,000 to £50,000,000.

CHAPTER X

THE BANKERS' CLEARING HOUSE: ITS SERVICES TO THE LONDON MONEY MARKET

If the ardour of the student of the London Money Market has not been damped by what he has read in the preceding pages, he will by this time probably be thirsting for an insight into the manner in which the documents, representing enormous sums of money, are dealt with each day by the London bankers through the agency of their Clearing House. Therefore, in order not to disappoint him, it will be necessary to give a summarized account of the Clearing House and its work

Origin of Bankers' Clearing House.

The Bankers' Clearing House seems to have originated in the year 1773 and, according to some authorities, was at first operated through a goldsmith banker;[1] but the system of setting off one bank's payments against another's was of much earlier date Some form of clearing appears to have existed in certain continental towns in the sixteenth century and, in 1752, there was a Clearing House in Scotland for the notes of the Bank of Scotland, the Royal Bank of Scotland, and the British Linen Company, 1752 is given as the date when a formal and regulated exchange began in Edinburgh; but, actually, the "great battle of the exchanges had been fought out in 1728–30, and subsequent encounters with the kites and crows of finance merely served to strengthen the agreement and proved its propriety."[2] As far as Great Britain is concerned, then, Scotland can fairly lay claim to be the "Mother" of the Clearing House system.

[1] *Cf.* footnote *Evolution of the Money Market* (p 305), Powell

[2] *Cf. The One Pound Note in the History of Banking in Great Britain* (p. 59), W. Graham.

Early Methods of Clearing.

Like so many other great institutions, the London Bankers' Clearing House had a most inauspicious origin; it started from the desire of a few bank clerks to save themselves trouble, and there never was a more striking example of the old adage that "Necessity is the mother of invention." A few walk clerks, weary of the monotony of trotting from one bank to another, impatient of the delays experienced at each office, conceived the brilliant idea of combining business with pleasure, and they arranged to meet, at lunch time, at a well-known chop-house in Dove Court, Lombard Street, the "Five Bells." In the public room of this inn, or on the posts in the court outside, so the story goes, the clerks used to exchange cheques and notes that they should have left in a more dignified manner at the various banks. One can well imagine the care that was taken to keep the knowledge of this rendezvous from the ears of their august seniors, lest the happy gatherings at which the exchanges took place over a chop and a glass of beer should be peremptorily forbidden. But no matter how much care was taken, the secret of these clandestine meetings was bound to come out sooner or later with the promotion of walk clerks to more responsible posts in the banks. Consequently, in course of time, this happy-go-lucky system of setting off one bank's notes and cheques against the other, and then settling the balance in notes and cash, was openly acquiesced in by the private bankers of the day. The practice, however, grew to such an extent that the bankers became genuinely alarmed at the large numbers of cheques and notes involved, so they bowed to the inevitable, and at first one of the banking houses allowed the exchanges to be made in a large recessed window of its office. The clerks, however, were a noisy, merry crowd, and they made such a commotion that the bank turned them out into the street once more. This forced the banks to take action to safeguard their interests, so they hired a room at the

"Five Bells," in which the walk clerks could meet daily and exchange their drafts openly.

A reference to this room is found in the books of Martins Bank, where a "Quarterly charge for use of clearing room, 19s. 6d.," is entered under a date in 1773. A few years later this place was found to be too small for the work carried on, and a larger room was rented from a Mrs. Irving, who occupied a private house adjoining the "Five Bells."

At this period, in 1777, according to old records in the possession of the National Provincial Bank of England (in which is merged the business of the old private banking house of Messrs. Smith, Payne & Smith), there were thirty-three banks in the Clearing House, all private bankers, be it noted. The daily clearing is given as about £105,000, the amounts due to the various bankers varying from £4 to £8,680.

The settlement was a complicated one: "An exchange of cheques was made between bank and bank as far as possible, then further amounts were settled by the handing over of surplus cheques on other banks in satisfaction of another bank's deficiency, and the ultimate settlement was made in notes and gold"

Established in Lombard Street.

From all accounts, Mrs. Irving's room was not a very cheery place, despite improvements; and, in 1805, the banks pensioned off the good lady and took ground floor premises belonging to a private bank in Lombard Street, Messrs. Smith, Payne & Smith's bank The bank clerks at that time worked longer hours than is the custom now, for we read of a chairman of the bankers' committee entering the Clearing House at midnight and ordering the bell to be rung to silence the clerks

As years went on, many alterations and extensions were made; and after occupying various premises, the "clearing" coterie took up quarters in a new clearing house

built by one Sir John Key in 1833. It was on the site of part of the present Clearing House, and had formerly been a courtyard of the old General Post Office. Many additions have been made since, and adjoining premises, extending from Abchurch Lane to King William Street, have been merged into the main edifice, which even to-day seems to be hidden away from prying eyes.

Admittance of Joint Stock Bankers.

In the early days there was no desire to extend the privileges of membership of the Clearing House, and for some considerable time the private bankers jealously excluded the joint stock banks. It was not until June 6, 1854, that the first of the joint stock banks was admitted. They were the London and Westminster, the London Joint Stock, the Union Bank of London, and the London and County Bank. Even then, for some considerable time, the private bankers and the joint stock banks had separate committees in the clearing representing their interests, but eventually all differences were sunk, and one committee ruled over the whole body. At present, this committee consists of one or more representatives from each of the clearing banks, with the Governor and Deputy-Governor of the Bank of England as *ex-officio* members.

In the early days, only the City banks were directly represented in the clearing, but with the growth of business, the passing of the old private banks, the amalgamation of the joint stock banks, and a closer alliance between all classes of bankers, the whole country has come to be represented in the clearing under the headings of Town, Metropolitan, and Country. Then the work has been still further developed and centralized by the institution of provincial clearing houses, of which there are now ten, viz., at Birmingham, Bristol, Hull, Leeds, Leicester, Liverpool, Manchester, Newcastle, Nottingham, and Sheffield.

The Staff.

The staff of the London Bankers' Clearing House consists of a chief inspector, a deputy inspector, and an assistant inspector. Each individual bank in the clearing also provides the clerks necessary to attend to its own particular business in the clearing. Generally speaking, the clerks provided by the banks form a floating staff, which changes from time to time as the men get transferred to other posts in their respective institutions, but a few of the banks have officials permanently attached to the Clearing House.

It is not our intention in this chapter to enter into a long detailed account of the operations conducted in the Bankers' Clearing House, since that forms a special study in itself; and the reader who desires full and complete information on the matter is recommended to peruse the very lucid account of the *Bankers' Clearing House: What It Is and What It Does*, written by a former chief inspector of the London Clearing House[1] However, the following summary of what takes place in the "House" will give the reader a general idea of the business.

"Out-clearing" and "In-clearing."

The timorous junior who first enters the Clearing House will be struck by the orderly array of desks, and for a moment might consider he had walked into the sorting section of the Post Office. Each bank has a desk allotted to it, and these desks are arranged round the room in alphabetical order to enable the clerks to pass round the room and deliver their "charges" or bundles of paid vouchers without confusion or error, and with the minimum of trouble. In a word, the task is made as simple as possible for the ever-changing staff. The operations involve what is called "Out-clearing" and "In-clearing," and, in this connection, it is necessary to remember that "out" and "in" items are really identical, for they

[1] P. W. Matthews

represent cheques, etc., presented for payment by one bank and their reception for payment by another bank For example, the "out" clearing of each bank (i.e. the lists of cheques, etc, drawn on or payable at other banks that are members of the Clearing House) become part of the "in" clearing of each other bank in the clearing (i.e. the cheques, etc, which other institutions in the clearing have to pay) It all sounds much like a jig-saw puzzle problem; but as the seasoned clearing clerk will say to the new junior whom he is initiating into his duties, "It all comes out in the wash," and a day on the job makes one familiar with the work.

The "out" clearing is taken down at the head office of the various banks in "out" books or sheets in separate "charges," according to the bank upon which they are drawn; while the "in" clearing is listed in the same way at the Clearing House itself by the clerks of each bank, who are sent there specially for that purpose.

Town Clearing.

A description of one section of the clearing will explain the method of procedure. We will take the Town Clearing. This opens at 10 35 a.m, and all drafts must be delivered at the various desks by 11.5 a m Immediately the "out" clearers, or the "charge side" as they are called, arrive at the Clearing House, they seek out their respective "in" clearers, or "pay side." The clerk receiving the charges enters the items in his "in" clearing book, rapidly casts them up, and agrees the amounts with those entered on the back of the last cheque. When the two clerks have agreed their respective totals, they strike a balance, and this is written on to the Clearing House sheet, the bank claiming on balance having its amount written on the debit side, and the bank paying on the credit side of the sheet. A similar process is gone through by each bank represented. This done, the clerks leave for their respective banks, taking the bundles of cheques and drafts with them.

The afternoon Town Clearing opens at 2.35 p.m., and drafts, etc., must be received not later than 3.40 p.m., when the last delivery is made.[1] The arrangements for the afternoon are similar to those for the morning clearing, except that deliveries are frequent and continuous throughout the whole afternoon. As soon as the last of the cheques, etc., have been dispatched from the banks, the casts of the "out" books are closed off and sent down to the Clearing House, to be agreed with the "in" books of the other banks. "Differences in adding the figures together are rectified by the bank in error, but differences in items are altered by the 'out' clearers to agree with the 'in' clearers. Subsequently, the difference may be reclaimed by production of the drafts. Drafts refused payment are returned at any time during the afternoon by inclusion in the 'out' charges to the bank by whom they were presented."

"Returns are received at the Clearing House not later than 4.50 p.m.," excepting on settling days and the first six working days in January and July, when the last delivery is 4.15 p.m. and returns 5.30 p.m.

When the totals have been agreed, "the balance between the 'out' and 'in' amounts is struck by each bank with every other one, and the last 'returns' are charged and allowed on either side. All these balances then form items in a General Balance Sheet, which is prepared by the head clearer of each bank, and shows at foot the final balance which his bank has either to pay or to receive. This balance is settled with the Clearing House by means of transfers made at the Bank of England between the

[1] On June 1, 1922, the hour of closing the Banks was extended from 3 p.m. to 3.30 p.m. Under the 3 o'clock closing conditions the Bankers' Clearing House was kept open until 3.40 p.m.; the non-clearing banks had therefore about a quarter of an hour's grace in which to pass their cheques to their clearing agents. Under the new rule the Clearing House will close at 3.50 p.m., consequently, only twenty minutes will be available for clearing operations instead of forty. In these circumstances there can be no period of grace allowed to non-clearing institutions.

Clearing House account and the accounts of the various banks"[1] Each clearing bank is obliged to keep an account at the Bank of England for the purposes of the clearing

When the final balance sheets are made out, the total of the transfers to the credit of the Clearing House must exactly equal the total of the amounts transferred from the Clearing House account at the Bank of England to those of the creditor banks Adjustments arising from errors are made in the next day's clearing.

Clearing on Saturdays commences earlier than on ordinary days, the morning clearing opens at 9 a m., and drafts, etc, have to be in not later than 10.15 a.m.; while the afternoon clearing opens at 12 noon and closes at 12 35 p m Returns must be in not later than 1.25 p.m. These times, however, are all extended on certain special days to meet the convenience of the banks.

A word remains to be said about the Metropolitan and Country Clearings

Metropolitan Clearing.

The Metropolitan Clearing was instituted in February, 1907, for the purpose of facilitating the clearing of cheques, etc., on various branch and private banks outside the City proper, and within a certain radius of Lombard Street. The system is worked through the head offices of the various clearing banks and the Clearing House.

Country Clearing.

The Country Cheque Clearing was established in 1858 and, as its name implies, only cheques are cleared through its agency, bills of exchange not payable on demand have to go forward in the ordinary way through one or

[1] *Cf Dictionary of Political Economy* (Vol I, p 306), Inglis Palgrave, *The Bankers' Clearing House* by P W Matthews; and article "London Bankers' Clearing House," by Robert Holland Martin, in volume on the *English Banking System*, National Monetary Commission, Washington

other of the big clearing banks; they are not collected through the country clearing.

The Country Cheque Clearing, is more complicated than the Town Clearing, because a settlement does not take place until two days after the cheques have been presented. The procedure is the same as in the Town Clearing, with the exception that, in agreeing, the cheques are not sent away from the Clearing House before the charges have been agreed.

Annual Report.

At the end of each year the Hon Secretary of the London Bankers' Clearing House presents an informative report on the past twelve months' working. In it there are included records of the amounts of the bills, cheques, etc., paid, together with the totals from 1872 onwards. The report also contains a record of the monthly and half-yearly payments for the past ten years. The following extract from the 1937 report will give the reader an idea of the vast sums that pass through the Bankers' Clearing House during the course of a year.

The totals of bills, cheques, etc., paid at the Bankers' Clearing House during the year 1937 are given in the following table, together with the figures of 1936 for comparative purposes—

	1937	1936
Grand Total	£42,686,309,000	£40,616,574,000
Town Clearing Total	£36,719,471,000	£35,039,356 000
Metropolitan Clearing Total	£2,161,700 000	£2,039,620 000
Country Cheque Clearing Total	£3,805,138,000	£3 537,598,000

To those who make a study of trade conditions the Report of the Bankers' Clearing House is always of interest. However, it is not, as might be supposed, the figures of the Town Cheque Clearing that reveal trade conditions, but those of the Country Cheque Clearing. The explanation is that

the Town Clearing is so considerably influenced by the daily transactions in the Short Loan Market, and by other purely financial operations, that it is unwise to use these figures as a reliable guide to the general trade conditions of the country.

Abstract of Records.

The following abstract of records to June 30, 1930, will be of interest—

Record Day—Monday, June, 30, 1930 .	£282,157,000
,, Week—Week ended July 2, 1930 .	£1,121,133,000
,, Month—January, 1929 . .	£4,274,313,000
,, Year—1929	£44,896,677,000

The Great War ended in November, 1918, and in order that the reader may have data in convenient form, to enable him to trace the movements in the amounts passed through the London Bankers' Clearing, we give the principal clearing statistics for the years 1918 to 1937 inclusive—

000's omitted thus, £1,000 = £1,000,000

Years	Total Clearings	Town Clearing	Metropolitan Clearing	Country Cheque Clearing	On Stock Exchange A/c Days
1918	21,197,512	17 031,628	1,429 611	2,736,273	1,725,563
1919	28,415,382	23 214,685	1,813,929	3,386,768	2,316,366
1920	39 018 903	32 852,933	2,093,750	4,072,220	3,090,895
1921	34,930,559	30,268 214	1,660,166	3,002,179	2,963,540
1922	37 161,461	32 780,635	1,574,661	2,806,165	3,418,607
1923	36,627,592	32,270,373	1,546,565	2,810,654	3,798,597
1924	39 532,864	35,038,605	1,594,114	2,900,145	3,600,343
1925	40 437,119	35,801 264	1,678,347	2,957,508	3,740,089
1926	39 825,054	35,346,429	1,660,757	2,817,868	3,947,068
1927	41 550 541	36,819,682	1,758,032	2,972,827	3,980,403
1928	44 204,729	39,311,117	1,854,190	3,039,422	4,427,351
1929	44 896,677	39 935,924	1,881,989	3,078,764	4,438,659
1930	43 558,354	38,782,577	1,812,146	2,963,631	4,195,723
1931	36,235,869	31 815,808	1,667,852	2,752,209	3,385,973
1932	32,111,959	27,833,633	1,610,407	2,667,919	3,027,195
1933	32,137,626	27,714,480	1,656,675	2,766,471	3,184,800
1934	35,484,157	30,740,117	1,759,528	2,984,512	3,464,795
1935	37,559,751	32,443,575	1,887,112	3,229,064	3,696,203
1936	40,616,574	35,039,356	2,039,620	3,537,598	4,152,908
1937	42,686,309	36,719,471	2,161,700	3,805,138	4,244,344

The Clearing House Reports are always interesting, and

in view of the peculiar circumstances of the time, that for 1921 was particularly so. In the Report for that year was recorded the absorption by Lloyds Bank, Ltd, of the business of Messrs. Fox, Fowler & Co, Wellington, Somerset. This amalgamation, the report mentioned, involved the disappearance of the last bank in England and Wales possessing the right to issue its own notes.

At the close of the Napoleonic Wars in 1813, there were over 900 banks in England and Wales issuing their own notes, every small town having its bank; but as soon as overseas trade was resumed and prices, particularly the price of wheat, began to fall, many of these banks were soon in difficulties: they were small and their resources were very slender, but there is no record of the nature of their liabilities and assets In the years 1813–15, 280 of them failed; and in the financial crisis of 1825 many more went under, no fewer than seventy of these banks closing their doors within a period of six weeks. In 1844, when the Bank Charter Act was passed, there were 207 private banks having the right to issue their own notes; in 1901 there were thirty such banks, and in 1919 there remained only six, and now the last of them has disappeared.

"It is of interest at the present time," says the writer of the Report, Mr. R Holland Martin, C B, "to compare and contrast the position of banking in this country, after a terrible and devastating war, with the position as outlined in the preceding paragraph, when, a century ago, this country was emerging from a prolonged struggle and when many of the problems which are engaging our attention now were also those which faced our predecessors then." There are now twenty-eight banks doing business in England and Wales whose drafts (with two exceptions) pass through one or more of the three clearings, as follows—

Bank of England	Grindlay & Co
Martins Bank, Ltd	Hoares
Barclays Bank, Ltd	Holt & Co
Coutts & Co	King, H S & Co
Glyn, Mills, Currie & Co	McGrigor, Sir C R & Co

Lloyds Bank, Ltd
Westminster Bank, Ltd
Drummonds[1]
National Bank, Ltd
National Provincial Bank, Ltd
Williams Deacon's Bank, Ltd
Child & Co
Cox & Co
Equitable Bank, Limited
Stilwell & Sons[1]
Dingley & Co
Midland Bank, Ltd
Gunner & Co
Lancs & Yorks Bank, Ltd.
Manchester & County Bank, Ltd.
District Bank, Ltd.
Union Bank of Manchester, Ltd
Yorkshire Penny Bank, Ltd

Notwithstanding the fact that a very large number of comparatively small institutions have been absorbed into the large banks of to-day, the banking facilities in this country provided by the banks above-mentioned are so widespread that at the present time there are over 7,500 banking offices in England and Wales

[1] Drafts on these banks are included in " Walks " Collection.

CHAPTER XI

THE MONEY MARKET ARTICLE OF THE NEWSPAPERS: ITS ORIGIN AND DEVELOPMENT

THE Money Market article, or rather series of articles, is rather a wonderful product of present-day journalism, and the City Editor of our great newspapers performs an important service. His position in the City of London is really unique, so, before we examine his daily contribution to the wealth of literature with which the Press of to-day furnishes us, it may be of interest to take a peep beneath the mystic shades of antiquity in order to learn what were his doings before he came forth into the hurly-burly of the twentieth century.

The First Money Articles.

Newspapers had been in circulation a good many years before it occurred to an enterprising editor to make an attempt to cater for the commercial and financial world The City article as a distinctive feature of the daily papers, in fact, dates back no further than about the year 1823; it is, therefore, only just over a century old.

It is doubtful with whom the idea originated Some people claim that *The Times* was the first newspaper of repute to publish regularly the City article; others give the credit for the innovation to the *Herald*, a newspaper which enjoyed some popularity in the early fifties, but which for some reason or other has long since disappeared. Despite the obscurity attaching to the originators of the scheme, the fact remains that, once the City page was started, its importance was immediately recognized, and the example of one paper was soon followed by all the other journals of the day. From the year 1824 to the present time the public has been favoured with a regular supply of City news in concrete form. Prior to 1824, the

editor of the *Thunderer* and his contemporaries had been content to publish isolated paragraphs giving such items of information concerning the world of commerce as they thought to be of general interest. No very prominent position was given to this news until the more important era which followed the close of the Napoleonic Wars.

Craze for Speculation Checked.

We do, it is true, find in the papers published during 1717 and 1718 regular references to the price of Consols and other important securities then favoured by the investing public, but the list was rather a haphazard one, furnished by some stockbroker or other, who for this service was allowed to have his name and address printed at the bottom of the list, this gratuitous advertisement seemingly being considered adequate payment for his trouble. The plate facing this page is an interesting example of the method in vogue at that period. As interest in these announcements increased, the enterprising editors gave more space to City items, and, when in 1817 the craze for forming joint stock companies started, more and more attention had to be given to the kaleidoscopic changes in the City. A craze for the wildest of wild speculation set in; details were all promptly chronicled by the editors in their City news; a panic looked imminent; the City scribe, in the fullness of the knowledge he had gleaned from the markets, foretold the inevitable day of reckoning. His comments were given in that terse, nervous English which is so marked a feature of the City articles of our time Then, as now, readers were warned, with due solemnity, to cut their losses and to get rid of their commitments before the crash People commenced to get uneasy; some took the advice tendered by the editor and sold their stocks and shares, others, like the incredulous folk in Sodom and Gomorrah, ignored the advice so freely given, and were shortly afterwards found bewailing the black ruin that came upon them as

the result of the failure of the banks and other respectable business houses. This period was a time of much distress and great heart-burning, and there is little doubt that the Press, or rather the City part of it, was in no small measure the means of purifying the atmosphere of City life. Fearless exposure was the order of the day, and there were not wanting brokers who complained that the Press had ruined their markets; but the louder they were in their complaints against the prejudices alleged to be encouraged by the newspapers, the quicker was the public to realize the real position of affairs. In short, "as the medicine operated, so the disease began to disappear," and thus was the power of the City Press developed in all its fullness.

City Editor as Guide.

Henceforward the public looked to the City pages of the papers for guidance. Thus encouraged, the City editors began to extend their contributions; they were unflinching in their criticism of those financiers who merited censure, and it began to dawn upon the dealers in money, and all that pertains to it, that a new power in the land had sprung up. They recognized that the Press was beginning to exercise something in the nature of an occult influence over the commerce of the country, and such was the power of the high-class newspaper of the time that City people feared to incur its displeasure by shady practices. The fearlessness with which the writers of the City article exposed anything tainted with fraud or questionable dealing, the promptness with which they laid bare to the public the designs of roguish speculators, and the ready explanations they gave of the failure of bubble companies or undertakings, made them a power to be reckoned with: the heartless promoters of bogus or shady enterprises began to be afraid of the lynx-eye of the newspaper's City representative. It was high time, too, for one reads with amazement the list of companies published by the newspapers during the years 1825–26. It is a record of infamy,

plunder, and sacrifice, of fraud and cajolery; it reveals a gullibility on the part of the public comparable with that which causes some of the African and other native races to barter valuable commodities for a few highly polished cowrie shells. In the records we find included every description of association under the sun; the list goes from the sublime to the ridiculous Hundreds of projects are mentioned, ranging from fantastic proposals for the extension of the principles of life assurance to the formation of a patent washing company to be established on the Isle of Dogs It mattered little that City editors referred their readers to the disasters that arose out of the reckless speculation engendered by the formation of the South Sea Company in 1710—a document in connection with which will be found facing this page; the newspapers did their best, but it was a case of history repeating itself; and not till many fingers were burned was the public appetite satiated.

There have been many other crises and panics since that of 1825-26; the hand of the City editor has lost none of its cunning in describing them, and in warning the investors of the consequences of a too ready belief in the strange and devious devices engineered by the "crooks" of the City More careful reading of the advice given by City editors would have saved many people from the heavy losses they sustained over the rubber boom of comparatively recent years.

The News Service.

Of course, to accomplish this task, the City editors are bound to maintain a highly developed news service. Not only are they kept in touch by mail and cable with the more important financial happenings in all parts of the world, but they and their assistants are early in the City paying visits to the various sections of the market, and to the banks and financial houses, to find out what is going on.

Present methods are reminiscent of the old days. When

the City article originated in 1825–26, the editors used to rely upon the news that could be picked up in the various coffee-houses in the City. One of the most important of these meeting-places was the North and South American Coffee House. The City scribes used to rent a room in this "tuck-shop," and there one would find them industriously occupied in writing down on small slips of paper the "tit-bits" of City information they had been able to pick up in the course of their wanderings. The coffee-house was a regular rendezvous for those who were anxious to meet the representatives of the papers and to hear their views on politics, trade, and finance. Great were the discussions that took place in their attempts to "draw" the collectors of information for the newspapers. Amusing were some of the dialogues that ensued, and City correspondents sometimes found their rather trying occupation enlivened by such interludes as the following.

An Incident in News Search.

The colloquy was between a respectable Hebrew merchant and a Yankee, who, having just left his native soil, felt himself particularly privileged to give his idea of the condition of affairs in England. The Hebrew appears to have lost money by the failure of an American bank, and in consequence had no great respect for the people who had promoted so monstrous a "bubble" as the bank had proved to be. The American perceived the Jew's animus against the States, and so he turned the conversation on to the subject of the war with America, and said—

"I should, by all the powers on airth, like to see Old Hickory give the Englishers a licking—they desarve it; that they do mightily."

"But you know you cannot. Where are your forces, your steamers, all your requisites for such a war?" replied the Jew.

"Requisites, did you say?" "Why, our militia would be enough to scatter like a whirlwind all the reg'lars you could bring into our country."

"Oh!" said the Jew, "we should only have to blockade

New York, and place a few steamers at the mouth of the St. Lawrence; turn up the Southern States against the Northern; and then you'd see where you'd be."

This was delivered with an air of immense satisfaction.

"I guess I should," replied the American; and then, after a moment's cool reflection, he turned to the Englisher and said, "But you've got to do it fust—talk of what you'd do—you may"; and, raising his arm, "but it won't alarm we—oh, no. I've seen your Woolwich, your Greenwich, your Portsmouth, but you carn't, with all your arsenals, beat us. Have you seen our Springfield?"

The Jew confessed his ignorance of the spot.

"Then, till you have," said the Yankee, "and observed our gun manufactories there and a'teen the Alleghany Mountains, never pretend to give an opinion on our capabilities. Just also look at our sea-board, and see how we stand there. I guess you'd find your mistake, stranger; and, therefore, while we're cool, let's discontinue the discourse."

Just at this point we may imagine another *habitué* of the coffee-house to enter, whose first inquiry would probably be—

"Well, Joe" (*Joe being the waiter*), "what's in?" (the inquiry meaning, "What vessels have arrived?")

The reply might be: "There's a vessel from the States, and another from Rio, but they are not so late as the last arrivals. We have a report that the *Hibernia* is off Liverpool; if so, we shall have the letters by the two o'clock delivery."

Another reply might be—

"The West India mail is in, sir. The crops appear good. They've had bad weather at Jamaica, and a bad fire at Barbados. The packet brings a good remittance for the Mexican dividend, but the official account is not yet out."

Still another searcher after news would ask—

"What's from the States?"

"They talk of Pennsylvania resuming next half-year, sir. The *New York Herald* has a long account about it. Exchange is rising. The accounts of the crops in the South are favourable for our market. No quotation for United States bank shares. Ohio sixes are up 2 per cent. Little movement in anything else."

So it would go on, and so would the notes of the City scribe increase. An hour or so before he was due to return to his office he would be busily engaged in separating the good news from the dross, and ultimately would hand in his prepared paragraphs for the next morning's paper.

City Article in 1914.

Times have changed since then, and we have changed with them; but the City correspondents have still to do a good deal of garnering of news and subsequent sifting, and the City article of to-day is a much more erudite epistle than it was in the good old times. Those of us whose privilege it was to read it during the sad and exciting days of August, 1914, and who followed it down to the joyful days of November, 1918, were astonished at the ease, the skill, and the erudition displayed by the City editors They treated the world to a perfect feast of literature, ranging from the dry-as-dust dissertations on economics to the exhilarating joys of higher finance. They told people how and how not to save money: they even ventured into the realms of prophecy—when it was safe to do so—and, taking their cue from the trend of events in the financial world, were able to point to signs of the coming of peace.

The City article is undoubtedly read in commercial circles with much interest and no little enjoyment. We go further, and say that the perusal of the City news is becoming more and more important to a wider circle of the reading public. At one time, the Jones, the Smiths, and the Robinsons were only interested in the price of the shares they held in City tea-shop ventures, far-away rubber plantations, or in gold mines in South Africa or Australia The War has changed all that. People still watch their shares rising or falling in value; but, our versatile City editor having taken upon himself to initiate us into the darker mysteries of the appreciation and depreciation of money, people turn to his writings to see how the quotation

for the pound sterling is progressing in other centres, or what progress is being made at the innumerable conferences to resurrect the fallen fortunes of those countries like Austria, who are still far from being in a satisfactory financial position In fact, the columns of the City page are becoming something more than a closed book to the anaemic denizens of our overcrowded railway carriages. The truth is the men and women of to-day who wish to be something more than mere nonentities can no longer afford to ignore the City news; they are expected to be able to discuss it with the men of affairs; consequently, the City article has not only progressed, it has also advanced in favour. It is not only a complete guide to the commercial business of the metropolis, but also a reliable record of the happenings in monetary circles all over the world.

Contents of Money Article.

Now, a word about the contents of the Money Article, over which the City editor spends so much care.

The City pages of all the principal daily newspapers are much alike. On the one will be found such headings as: "Finance and Commerce—City News"; on another, "City Facts and Figures"; on a third, "Finance, Commerce, and Industry"; and so on.

The first column usually takes the form of a précis of current events in banking and financial circles. In it the City editor gives the "cream" of the news which has come into his possession the previous day, and he comments on and criticizes movements in money, discounts, exchanges, and so on The position of the various firms, companies, corporations, and banks receives praise or condemnation, as the case may be, at his hands. Anything likely to guide or interest the man in the street or the woman in the garden is dealt with succinctly, and the editor does not stop at happenings in London or the United Kingdom He roams far afield: the European situation, the American Debt Settlements, affairs Chinese

and Japanese, Moroccan intrigues—all are cleverly and dispassionately reviewed. Such comments pave the way for an intelligent understanding of what follows.

In further columns are discussed the principal items of money market news. "The Money Market—2⅝%—"Depreciation of the Spanish peseta"; "Borrowing at the Bank"—"Harder Money Prospects"—"Banking Notes"—"Conditions in the States," are some of the headings that will catch the busy reader's eye

Quotations and Discounts.

The column dealing with the money market describes the quotations for money and discounts on the previou day. Starting off with the current Bank Rate, it goes on to give the rate of interest allowed by the joint stock banks on short deposits Then follow the rates allowed by the brokers for deposits, and those that are charged for day-to-day money and weekly loans The discount quotations appear next, and include the quotations for bank bills and fine trade bills, all of which have been described in our previous pages. Mention is also made of any transactions that have taken place. Cause and effect of high or low rates are discussed, and anything which is expected to influence future movements in money or discounts is noted. On Saturdays these details are supplemented by a short table giving the results of the tenders for the British Government's Treasury Bills; these comprise the amounts offered for tender, the applications, the allotments, and the average rate of discount. If the editor has space available, there will also appear similar details for the whole of the month. Information is also given of the rates of discount at which Treasury Bills, with various periods to run before maturity, have been changing hands on the open market.

Foreign Exchange News.

The Foreign Exchanges, which at one time received scant attention, are now very fully described, and occurrences

affecting the depreciation or appreciation in the value of the pound sterling in foreign centres are closely examined. A complete table of the rates quoted on each foreign centre is given; the place, the method of quoting, the par of exchange, and the rates for the two previous days all being neatly tabulated. The table is usually preceded or followed by the editor's notes and comments on variations in the quotations for the principal currencies that have taken place, and these afford a ready guide to those whose business lies with foreign countries. In some cases the rate given in the table represents the value of the pound sterling on the centre named, and in other cases it gives the value of one unit of the foreign currency in sterling. In New York, for instance, the quotation is so many dollars and cents for £1, and, in Paris, so many francs and centimes for £1, while for the Eastern centres and India the rate is quoted in shillings and pence for one Hong-Kong dollar, or one Indian rupee, and so on. Then, again, for some places, like Rio de Janeiro, the quotation is so many pence and fractions of a penny per milreis, payable by telegraphic transfer, that is to say, for every milreis paid to a banker in Rio de Janeiro, he will telegraph to his London agent to pay over to the person indicated in the telegram the sterling equivalent, and vice versa.

Foreign Exchange and Money Market.

The question of the foreign exchanges is, of course, an extremely complex one, and as the whole subject has been very fully explained by the author in five previous books,[1] it is only necessary to refer here to the connection between the foreign exchanges and the London Money Market. Briefly, then, they are of importance to the reader of the money article, because they give him a clue to the varying influences of the rates of money on various markets. For

[1] *Foreign Exchange and Foreign Bills in Theory and in Practice. Eastern Exchange, Currency and Finance. A Primer of Foreign Exchange. The Functions of Money. Bankers' Credits.*

example, if the rates of discount or interest in London are above the level of those ruling in foreign centres, in normal times, the result will be a flow of remittances from foreign centres to London for investment in London bills of exchange. This has a tendency to lower the rate of exchange in London on the foreign centre concerned, and to raise the rate of exchange in the foreign centre and elsewhere on London. The reason is this. Foreign dealers will be eager purchasers of all forms of remittances on London, and the increased demand influences exchange; it makes the value of the pound sterling go up. If sufficient remittances are not procurable in the one centre, exchange operators will turn their attention to other centres in which it may be advantageous to purchase remittances for the purpose of sending money to London, and this, in turn, influences the rates on other centres in our favour. The incentive, as we have said, is the higher rate of interest ruling on the London market.

In this connection, comment made by an American writer is illuminating. He wrote: "Increased interest in England tempts investments there rather than in the United States English banks are more likely to invest current funds at home, and may even draw on debtor banks in the United States and other countries. American and other banks may be tempted to make short term loans in England or to hold, or to have held until maturity, long bills which they would otherwise have immediately discounted. This holding of drafts until maturity will compel them to buy more drafts on England than otherwise would be necessary, in order to maintain their usual balances. The general result of a high discount rate in England is, therefore, a high rate of exchange on and a flow of gold to England. Similarly, a sharp rise in the discount rate in New York would tend to produce elsewhere a high rate of exchange on New York, and would tend to cause a flow of gold to New York"[1]

[1] H. G. Brown in *International Trade and Exchange* (New York).

Gold and Silver Prices.

From a consideration of the foreign exchanges, the City editor passes gracefully to a brief summary of the reasons for the rise or fall in the prices of gold and silver on the London market, in both of which metals America is keenly interested at the present time He indicates to the best of his ability the figures of the imports and exports of the metals, whether China is a buyer or seller of silver, and whether France or the United States has taken the greater part of the latest import of gold from India. Then he discusses, very briefly, the tone of the market. The bullion market is a highly technical one, and is, therefore, left to be explained fully in our next chapter.

Stocks and Shares Section.

After dealing with gold and silver, the remainder of the City editor's pages are given over to a discussion of Stock Exchange matters, etc., and are accompanied by a full record of prices of the principal stocks and shares. The tendency of the newspapers at the present time is to publish an extensive summary of the quotations under many different headings; this facilitates reference by those who are interested in the various securities.

The first paragraph in the stock and share sections of all newspapers deals with gilt-edged securities, such as British Government funds, Corporation and County stocks, Colonial Government securities. Then follow details of first-class foreign government securities. British railway stocks are also given early prominence in the list of quotations, and these, as a rule, are followed by the prices of colonial, American, and foreign railway stocks. The quotations for the shares of banks, finance houses, and insurance companies usually come next, and then follow a whole host of industrial and miscellaneous securities, most of them sub-divided into groups, which are of as much interest to the average investor as to the money and stock market magnates. Shipping and canal shares,

shares of textile and dry goods companies, electric light and power and gas stocks, rubber and oil shares all have their separate places; and the newspaper reader soon comes to learn under which section to look for the latest quotation for the shares of the concern in which he is a part-proprietor.

Any special points about the dealings in the stocks and shares are noted by the City editor, and prompt notification is always given of dividend declarations, issues of new shares, flotation of new companies, and the like; scarcely anything escapes the eagle eye of the City editor or his assistants.

American Market.

Over and above all these points we have enumerated, our friend the City editor has other news with which to regale the reading public on special days. The American section of the market, for one thing, is always given a good deal of space: the latest quotations for shares, details of railway earnings, harvest reports, and the hundred-and-one happenings in Wall Street, New York, are all discussed briefly and in an expert manner.

Home and Foreign Rails.

On Wednesdays and Thursdays will be found detailed accounts of the traffic returns and revenues of the home and principal foreign and colonial railways. Then, on the 10th of each month the preliminary figures of the foreign trade of the country are given, followed about the 15th of the month with special articles on the published statistics of the Board of Trade, in which the progress or otherwise of our imports and exports are recorded.

Bank Returns.

On Friday morning the City columns are replete with information on the Bank of England Return, which, as we have shown on previous pages, is published on Thursday

afternoons by the Bank. The City editor gives the Return *in extenso*, and accompanies it with comparative figures of previous Returns, and he notes the rise or fall in the ratio of reserve to liabilities, besides commenting on other aspects of the Return Then any addition or decrease in the note circulation is recorded, and the reasons for the contraction or expansion given Thursday, as a matter of fact, is always a very heavy day for the City writers Space has to be found in the next day's issue for comment on the Weekly Return of the Bankers' Clearing House, which is also issued on Thursday, and here again comparative figures are given, together with the day-to-day record of the week's clearing. Further, at the beginning of each month appear the banks' statements for the previous month, and an analysis has to be made of the deposits, the cash in hand and at the Bank of England, cheques in transit, cash at call and short notice, bills discounted, investments and advances, etc., of the ten clearing banks On other days there are the returns of the State banks of the principal foreign countries to be published, and any special changes in their figures require to be noted. The Revenue Returns of our own and foreign governments have also to be dealt with as they are available, to say nothing of the annual Budget statement, and the inevitable discussion of the pros and cons for various taxes.

Shipping and Mails.

Finally, for those who are interested, extensive details are given of shipping movements, arrival and departure of mails, and of the commodities dealt with in all the produce markets at home and abroad. It is beyond the scope of this book to deal with the transactions that take place at the Royal Exchange, Lloyds, the Baltic, the Mincing Lane Sale Rooms, the Metal Exchange, Billingsgate Market, Smithfield, and similar markets; but the City editor has to give attention to the doings of all of them,

and has to gather news from each section to-day in the same way as his predecessors used to garner and collate news from the old coffee-houses a century or so ago.

In this chapter it has been possible only to touch upon the fringe of the many subjects of which the City page has a record. To deal adequately with most portions of the money article would necessitate our writing not one but many books; but sufficient has been said, we hope, to indicate to the reader what a wealth of information there is to be obtained if he will only partake of the varied dishes the City editor serves up so regularly each morning with his tea and toast.

Certainly, since the year 1931, the Money Article of all the great dailies has been read more widely than possibly at any time in the history of the country. The departure of Great Britain from the Gold Standard in the autumn of 1931 had consequences more far-reaching than had perhaps been imagined, and not many months had passed before the denizens of the morning trains were turning eagerly to the Money Article in an endeavour to learn the latest rates of exchange for the pound sterling, or what was the latest price for gold or silver, as the case might be. However, the eventful passing from the Gold Standard merits treatment in a separate chapter.

CHAPTER XII

THE LONDON MONEY MARKET DURING THE YEARS 1931 AND 1932

GREAT BRITAIN'S departure from the Gold Standard and its effects—The Bank Rate, Market Rate, and Short Loan rates from 1926 to 1931—The transition from high to low rates for loanable funds during 1932—The Government's Exchange Equalization Account—The Chancellor of the Exchequer's explanation—Other factors—Money Market items during 1932

WHEN the momentous step of amalgamating the British Treasury's Note Issue with that of the Bank of England had been accomplished in 1928, the world in general, and this country in particular, might well have considered that something like finality had been reached in bringing back Great Britain to the full Gold Standard. For two years or so, indeed, the country did seem to be within reach of the pre-War position. Yet, unforeseen events occurred to destroy the abiding faith we had in our ability to maintain gold payments. In the light of later events it has been proved that the whole world had mistaken the ultimate effect of Reparation and War Debt payments, and few could have realized the slough of despond into which Europe would be plunged. For years gold had been sent in large amounts to America and elsewhere to make up the balance of payments. Long and short term loans had been made to the impoverished nations of Europe, and, it has to be admitted, the proceeds of the borrowings had been more or less squandered without regard to the consequences. In a way, Great Britain, in the matter of gold, was left to play a lone hand, and the words of the Financial Secretary of the British Treasury, uttered some three years prior to the suspension of the Gold Standard, were particularly apposite to the situation that had developed by the summer and autumn of 1931. He said no country can either absorb or set free gold for monetary purposes without affecting

its neighbours. In 1931 Great Britain had been for some months setting free gold for export, while her neighbours had been just as assiduously absorbing it, with what result we now know. The full account of the events leading up to our departure from the Gold Standard and the immediate results—we have yet to experience the ultimate results—have been described fully by the writer in the Eighth Edition of *Foreign Exchange and Foreign Bills in Theory and in Practice.* The story has also been told and re-told over the four quarters of the globe, and has lost nothing in the telling. However, for the purposes of record it is necessary here to give the official account of how Great Britain departed from the Gold Standard on September 21, 1931, after an heroic struggle to maintain London as the free gold market of the world.

A Cabinet Meeting was held on the evening of Sunday, September 20, 1931, and the following official announcement was made the same night—

"His Majesty's Government have decided, after consultation with the Bank of England, that it has become necessary to suspend for the time being the operation of Sub-section (2) of Section 1 of the Gold Standard Act of 1925, which requires the Bank to sell gold at a fixed price. A Bill for this purpose will be introduced immediately, and it is the intention of His Majesty's Government to ask Parliament to pass it through all its stages on Monday, September 21 In the meantime the Bank of England have been authorized to proceed accordingly in anticipation of the action of Parliament.

"The reasons which have led to this decision are as follows: Since the middle of July funds amounting to more than £200,000,000 have been withdrawn from the London market. The withdrawals have been met partly from gold and foreign currency held by the Bank of England, partly from the proceeds of a credit of £50,000,000, which shortly matures, secured by the Bank of England from New York and Paris, and partly from the proceeds of the French and American credits, amounting to £80,000,000, recently obtained by the Government. During the last few days the withdrawals of foreign balances have accelerated so sharply

that His Majesty's Government have felt bound to take the decision mentioned above.

"The decision will, of course, not affect obligations of His Majesty's Government or the Bank of England which are payable in foreign currencies

"The gold holding of the Bank of England amounts to some £130,000,000, and, having regard to the contingencies which may have to be met, it is inadvisable to allow this reserve to be further reduced.

"There will be no interruption of ordinary banking business. The banks will be open as usual for the convenience of their customers, and there is no reason why sterling transactions should be affected in any way.

"It has been arranged that the Stock Exchange shall not be opened on Monday, the day on which Parliament is passing the necessary legislation This will not, however, interfere with the business of the current settlement on the Stock Exchanges, which will be carried through as usual.

"His Majesty's Government have no reason to believe that the present difficulties are due to any substantial extent to the export of capital by British nationals. Undoubtedly the bulk of the withdrawals have been for foreign account. They desire, however, to repeat emphatically the warning given by the Chancellor of the Exchequer that any British citizen who increases the strain on the exchanges by purchasing foreign securities himself or assisting others to do so is deliberately adding to the country's difficulties. The banks have undertaken to co-operate in restricting purchases by British citizens of foreign exchange, except those required for the actual needs of trade or for meeting existing contracts, and, should further measures prove to be advisable, His Majesty's Government will not hesitate to take them

"His Majesty's Government have arrived at their decision with the greatest reluctance. But during the last few days the international financial markets have become demoralized, and have been liquidating their sterling assets regardless of their intrinsic worth. In the circumstances there was no alternative but to protect the financial position of this country by the only means at our disposal.

"His Majesty's Government are securing a balanced Budget, and the internal position of the country is sound. This position must be maintained It is one thing to go off the Gold Standard with an unbalanced Budget and uncontrolled inflation, it is quite another thing to take this

measure, not because of internal financial difficulties, but because of excessive withdrawals of borrowed capital The ultimate resources of this country are enormous, and there is no doubt that the present exchange difficulties will prove only temporary."

The Bank Rate was raised from $4\frac{1}{2}$ per cent to 6 per cent as from the commencement of business on September 21, and on the same day the legislation necessary to the suspension of the Gold Standard was passed through all its stages.

The title of the Act is The Gold Standard (Amendment) Act, 1931, and the text is as follows—

1.—(1) Unless and until His Majesty by Proclamation otherwise directs, Sub-section (2) of Section 1 of the Gold Standard Act, 1925, shall cease to have effect, notwithstanding that Sub-section (1) of the said Section remains in force.

(2) The Bank of England are hereby discharged from all liabilities in respect of anything done by the Bank in contravention of the provision of the said Sub-section (2) at any time after the eighteenth day of September, nineteen hundred and thirty-one, and no proceedings whatsoever shall be instituted against the Bank or any other person in respect of anything so done as aforesaid

(3) It shall be lawful for the Treasury to make, and from time to time vary, orders authorizing the taking of such measures in relation to the exchanges and otherwise as they may consider expedient for meeting difficulties arising in connexion with the suspension of the Gold Standard.

This Sub-section shall continue in force for a period of six months from the passing of this Act.

2.—This Act may be cited as the Gold Standard (Amendment Act), 1931.

There remains to be added the announcement issued by the Treasury on September 9, 1932—

"The Treasury announce that the loan of 2,500,000,000 francs subscribed a year ago by the French public has been repaid in accordance with the terms of the original issue The whole of the foreign credits obtained by the Treasury at the time of the crisis in August and September, 1931,

have now been repaid in full, on or before due dates, without the right to re-draw either in whole or part being retained in any case."

It has been said that the Government and the financial pundits of the City of London ought to have been more alert and have seen the parlous position whither the nations of Europe had been drifting. It is easy, however, to be wise after the event, and this country was not alone in its failure to envisage the acute difficulties that were to occur. As doubtless the incidents of 1931 will stand out for many years as the most critical in the history of the United Kingdom, a review of the monetary happenings of the year may not be out of place.

Although it has to be admitted that in 1931 Great Britain had been heading for a crisis, yet, on the surface at any rate, the position of the London Money Market was such that casual observers could hardly have apprehended that, with the Bank of England rate at 2½ per cent, a strain of such a magnitude would so soon be imposed upon the market. When the storm actually burst, however, a feeling of nervousness was in the air, as heavy Continental failures had involved most of the money markets of Europe. Towards the end of June and well on into July, 1931, London was drawn into the vortex and had to stand up to the demand for funds, the like of which had not been experienced for ages. Foreign centres began to draw heavily on London for their balances, and, as the movement grew, it gained in impetus. During July, 1931, the Bank of England released no less than £30,000,000 of gold, and, in a vain attempt to stem the withdrawals, the Bank Rate was raised from 2½ per cent to 3½ per cent, and then to 4½ per cent. The open market followed by raising the market rate to 4–5/16 per cent, or, as *The Economist* put it, "to within 3/16 per cent of the highest Gold Standard Bank Rate of the year."

1931 may well be described as the most eventful year in our post-War monetary history.

"First came the 'revelations' in the May report on the state of our national finances, and the opening of the Bank of England's Paris and New York credits, amounting in all to £50,000,000. These were accompanied by the increase at the end of July in the Fiduciary Note issue from £260,000,000 to £275,000,000 and were followed by the downfall of the Labour Government. Then came the National Government, the balancing of the Budget, and the arranging of the £80,000,000 Treasury credit in Paris and New York. All this time the drain of funds from London continued, for confidence by then had been destroyed, and banks in France and the United States were faced with ugly rushes by their customers. Germany was by then being propped up by the standstill agreement postponing the repayment of British deposit and other short term balances. Foreign funds in other Central European countries were equally irrecoverable. The German Reichsbank rediscount rate had for a time been up to 15 per cent, and banking difficulties and note hoarding in France and America gave further evidence as to the intensity of the financial strain.

On September 21, 1931, the breaking point was reached. Withdrawals of foreign funds from London had by then, as we have seen, reached £200,000,000, and the Bank and Treasury credits were both practically exhausted. The Bank of England received authority to suspend gold payments; the Bank Rate was raised to 6 per cent; the Stock Exchange was closed for two days, restrictions were imposed upon foreign exchange dealings, and the pound fell initially to a discount of 20 per cent."[1]

For the rest of the year 1931, the London Money Market had to adjust itself to the new order of things, and, as time progressed, the market in Bank Bills of Exchange became extremely narrow. Business was largely confined to dealings in Treasury Bills. Although some little improvement in the foreign exchanges had been obtained, in the course of a month or so after our departure from the Gold Standard, in November, 1931, the pound sterling depreciated again and money rates tightened up, but by the time the War Loan interest had been paid in December, the rates for

[1] Cf *Economist*, January 2, 1932

money came down with rather a run. In view of the importance of the year 1931 to British monetary history, and as a matter of general interest, we give *The Economist* table showing the average level of money rates for 1931 as compared with those ruling in previous years.

BANK RATE

	1926	1927	1928	1929	1930	1931
	£ s d	£ s d	£ s d	£ s d	£ s d	£ s d
First half	3 – –	4 16 –	4 10 –	5 5 11	3 16 9	2 17 2
Second half	3 – –	4 10 –	4 10 –	5 16 –	3 – –	5 – –
Whole year	3 – –	4 13 –	4 10 –	5 10 –	3 8 5	3 18 7

MARKET RATE—THREE MONTHS BILLS

	1926	1927	1928	1929	1930	1931
	£ s d	£ s d	£ s d	£ s d	£ s d	£ s d
First half	4 9 6	4 3 3	4 1 –	5 1 5	3 – –	2 8 –
Second half	4 11 –	4 6 6	4 5 –	5 9 3	2 4 7	4 14 –
Whole year	4 10 3	4 4 10	4 3 –	5 5 4	2 12 3	3 11 –

SHORT LOANS

	1926	1927	1928	1929	1930	1931
	£ s d	£ s d	£ s d	£ s d	£ s d	£ s d
First half	4 1 2	3 17 6	3 13 –	4 8 2	2 19 9	2 1 8
Second half	4 1 –	2 12 6	3 12 –	4 14 3	1 19 3	4 – –
Whole year	4 1 1	3 15 –	3 12 6	4 12 3	2 9 6	3 – 10

It remains to be added that, in the uncertain and strained atmosphere of 1931, British bankers conducted their operations with difficulty, albeit also with signal skill. Their reports for the year were keenly scrutinized at home and abroad, and there is no doubt that the strength and stability demonstrated by the balance sheets of the banks was one of the most potent influences in the revival of the confidence of the whole world in the financial position of the country.

"Nothing," said the London *Economist*, "could have surpassed the difficulties of the year 1931–32. It began

and ended with rates at an unremunerative level, it witnessed a shrinkage in the banks' resources, and it subjected the banks to the need of making abnormal provision for depreciation, bad debts, and other capital losses. It is, in fact, a high testimony both to the strength of the British banking system and to the confidence deservedly reposed in it by the public that not only did not a single banking failure occur—and in this Great Britain is almost unique among all the countries of the world—but that there was never the slightest sign of any loss of confidence, or of the withdrawal of deposits or hoarding of notes or coin by the British public."

The London Money Market position ever since the dark days of 1931 has been replete with interest, so to complete our survey a summary of the happenings of the year 1932 will be useful to both the student and the man in the street.

The curious point about 1932 was that rates for money in London dropped to the lowest level that had been recorded since the nineties, when, from February 22, 1894 to September 9, 1896, a 2 per cent Bank Rate had ruled. The imposition of a 6 per cent Bank Rate when the country departed from the Gold Standard in 1931 may, or may not have been justified, but the subsequent reduction in Bank Rate was certainly rendered necessary by the world-wide contraction in trade and an almost calamitous fall in commodity prices throughout 1932.

The effect of these main factors was accentuated somewhat by distrust of political and economic conditions in many other countries, for, at times, there was an unmistakable tendency for foreign balances to flow to London for safety.

But while the great cheapness of money in this country was essentially due to world causes, there is reason to believe that the steep decline in rates was assisted by the authorities, and, looking back, it is rather difficult to resist the conclusion that there were two reasons for the adoption of "the cheap money policy." One was a desire to prevent

an undue influx of foreign funds; the other had in view a conversion of the British Government debt to a lower interest basis; such conversion being on a scale far greater than the world had ever before witnessed. In the latter respect at least the policy achieved its object, for the Government were able to replace £1,920,000,000 of 5 per cent War Loan by a stock bearing 3½ per cent interest. This was the outstanding financial event of the year 1932, and the great success of the operation assisted the appreciation in fixed interest bearing securities that was primarily due to an abundance of credit available at exceptionally low rates.

An interesting feature, too, was the reduction in the Bank of England Rate from the high level of 6 per cent, to which it had been raised on our departure from the Gold Standard on September 21, 1931. The rate was reduced to 5 per cent on February 18, 1932, a month later, on March 10, it was lowered to 4 per cent, then again reduced to 3½ per cent on March 17, to 3 per cent on April 21, 2½ per cent on May 12, and to 2 per cent on June 30, 1932. This last rate was the lowest point touched for thirty-five years, and it is still maintained at that level on December 31, 1937.

Apart from the conversion of 5 per cent War Loan, the most interesting development, perhaps, was the establishment, in April, 1932, of the British Government's Exchange Equalization Account. The setting up of this account at the Bank of England was ostensibly for the purpose of preventing undue fluctuations in the exchange value of the pound sterling, and so important a step was it, and such has been the misrepresentation since, that we cannot do better than give an extract from the Chancellor of the Exchequer's speech in the House of Commons on April 19, 1932. He said—

"During recent weeks the exchange position of this country has been one of considerable difficulty. There has been a loss of confidence abroad and that loss of confidence has led to large accumulations of liquid capital which can

very conveniently be moved from one financial centre to another, and therefore materially assist the operations of speculators. The effect of the transfer of this liquid capital is to exercise a very disturbing influence upon the exchange, particularly upon the sterling exchange, which is no longer linked to gold.

"Since we were so successful in repaying the credits which were raised abroad last year and in balancing the national accounts, the tide of liquid capital has been setting very strongly in towards these shores. That is flattering to our vanity, but at the same time it is sometimes a serious embarrassment to our trade, and, moreover, in so far as it does not represent a genuine and permanent improvement in the balance of trade, is apt to give rise to dangerous development. In such circumstances nobody can say with certainty that the ebb may not set in presently, and therefore I have been driven by the force of events to this conclusion: that if we are to avoid violent and perilous fluctuations in our currency, especially those which are due to these speculative operations, if we are to enable this country to function effectively as the main international centre of the world, then it is essential for us to hold adequate reserves of gold and foreign exchange, in order that we may meet a sudden withdrawal of short-dated capital and that we may check and repel these speculative movements.

"I will try to describe to the Committee the proposals which I have in mind and I must ask for their indulgence if part of this matter appears to be somewhat technical in character. I propose to wind up the old Exchange Account and to use the assets as the nucleus of a new account to be called the Exchange Equalization Account. I propose to ask the Committee to give me powers to borrow up to £150,000,000 for this account. The details of assets in the account will not be published, but they may take various forms, either gold or—(An Hon. Member: Silver)—sterling securities or foreign exchange. That will give us a very large extended power of purchasing exchange. The new powers, combined with the powers already possessed by the Bank—on which, of course, the main responsibility for the management must continue to rest—will enable us to deal far more effectively than we have done hitherto either with an unwanted inflow of capital or, if the alternative should again arise, with an outflow of capital from this country. There are certain other purposes for which this

Exchange Equalization Account can be used conveniently. First of all, there is an accounting question connected with the weekly returns of the Bank. Hon. members know that there are two departments in the Bank—the issue department and the banking department. The issue department is liable for the note issue, amounting to some £400,000,000, against which it has assets in gold and securities. The banking department, on the other side, is the one in which the purely banking business is carried on. The management of the issue department is by law entrusted to the Bank, but its returns concern only the Exchequer, because the Exchequer is entitled to any interest earned or any profits made in the issue department.

"On the other hand, the profits of the banking department are for the account of the Bank. My proposals only affect the issue department, and I give that preliminary description in order to show that they do not confer upon the Bank any new privilege or any new profit. The Bank will continue to bear, itself, any risks which may be involved in exchange operations carried on in the banking department That arrangement is made at the Bank's own desire, and I am sure it is one which will be approved by the Committee

"With the pound divorced from gold the accounting arrangements of the issue department present some difficulties Its liabilities for the note issue are in sterling. Those of its assets which may consist of foreign currencies fluctuate in terms of sterling, but so far as its assets consist of gold—including any gold that may hereafter be acquired —the law requires the gold to be valued at the old par. Thus the issue department cannot, with the exchange at, say, 3 80, add £100 to its gold holding without showing an apparent loss of £28, and, in the same way, it cannot sell £100 of its gold holding without showing an apparent profit of £28, while its holdings of foreign exchanges fluctuate in value every week Our currency authorities ought to be free to hold such amount of gold and foreign exchange in the issue department as may be required without being hampered by technicalities of this kind.

"On the other hand, we must be very careful to keep our full cover against the note issue. I consider that at all times and in all conditions the assets of the issue department, that is to say the backing of the currency, should be consistently and conservatively valued, that gold should continue in each return to be valued at the old par, and the

foreign exchange assets ought to be valued at the current rate of exchange irrespective of their purchase price. In order that the accounts may at all times precisely balance on this basis, my proposals provide that, at any time when the valuation on this basis shows a deficiency, resources to the corresponding amount shall be passed from the Exchange Equalization Account to the issue department of the Bank, and when a surplus is shown the converse operation shall take place. I ask the Committee to observe that both of these accounts are worked for the credit of the Exchequer, for the use of the Exchequer, and for the account of the Exchequer. Therefore, it does not very much matter whether any particular assets are for the moment in one account or the other, both are for the account of the Exchequer.

"There is another point. In connexion with the credits which were raised by the Bank of England last year from the Banque de France and the Federal Reserve Bank, the undertaking was given at the time, and Parliament was so informed, that any loss arising from the transaction should be made good to the Bank. The Finance Bill, accordingly, will contain a provision charging £8,000,000, which is the outstanding loss on that transaction, to the Exchange Equalization Account. I may be asked, 'Supposing that these powers are given to the Government, will that be the final end to the fluctuations in the exchange, will that mean that the exchange will be kept at a fixed point, or, at any rate, that it will be maintained within a fixed range of value?' I am not going to give any such assurance. When you consider the economic disturbances which are still occurring in the world, and of which we probably have not even now felt the worst, it is perfectly useless to pretend that we can hold our position where we like, independent of anything which is going on around us. On the other hand, we can say this, that those who are charged with the conduct of our currency will be much better equipped in the future, with these powers, to maintain that currency steady than they have been in the past, and that to that extent we shall see a great advance.

"There is another question, 'Will these transactions involve the Exchequer in any loss, or in any considerable loss?' I think the answer to that must be that that is a very conceivable possibility. We do not know what is going to be the future of gold prices. We do not know what settlement will be reached as regards reparations and War

debts and other matters which are now disturbing the world. These uncertainties rule out any possibility of our being able to return to gold immediately. We do not know when and in what circumstances we may return to gold or at what level. If, in the long run, we were to return to gold in such a way that the pound stood at a higher gold value than the average level at which purchases of exchange had been made the transaction would inevitably show a loss. This is a possibility, but it is not one that should deter us. If we are merely seeking safety, from an accounting point of view, then, of course, we can proceed exactly as we did during the earlier period of suspension of the Gold Standard between the years 1919 and 1925. The pound would be allowed substantially to take its own course, liable to fluctuations with every seasonal movement of trade, every outburst of speculation, or change of sentiment caused by developments abroad. The problems of the present time are altogether different from those which faced us immediately after the War. In my judgment the risks entailed by uncontrolled fluctuations of currency to-day outweigh those of possible losses on the transactions I have mentioned"

The Exchange Equalization Account was established, as the Chancellor of the Exchequer implied, by using as a nucleus the assets in the old Dollar Reserve Fund, and these amounted to some £25,000,000. In addition, it will be noted, the Government took powers to borrow up to £150,000,000 for the fund For some years no information was vouchsafed as to the administration by the Bank of England of the funds in the account.

However, it quickly became apparent that the resources held in the Exchange Equalization Account were insufficient for the operations carried out, and in 1933, about a year from the inception of the Fund, it was further increased by £200 millions in Treasury Bills. Towards the end of June, 1937, the statutory size of the Account had grown to £375 millions, and the London Money Market had come to regard that amount as fixed. Some surprise was evinced, therefore, when on June 23, 1937, the Chancellor of the Exchequer announced in the House of Commons that it had

been decided again to increase the Fund by £200 millions to £575 millions. Nevertheless, the transfer in December, 1936, of £65 millions in gold to the Bank of England, to which reference has been made in a previous chapter, was a sure indication that the Fund must have been nearing the end of its liquid resources.

At the same time the Chancellor of the Exchequer, after five years of complete secrecy, announced the intention of the Government to lift the veil of secrecy from its past operations. He indicated that henceforward, each December 31 and June 30, the state of the account on the preceding September 30 and March 31 would be published.

The first official statement showing the position on March 31, 1937, was made at the end of June. This revealed that the gold holding of the Fund amounted at 140s. per ounce to 26,674,000 fine ounces, valued at £186·7 millions, and that held by the Bank of England as 73,842,000 fine ounces, value £516·9 millions.

On December 30, 1937, a further statement was published giving particulars of the Fund as at September 30, 1937. The gold held in the Account was 39,854,000 fine ounces, valued at 140s. per ounce at approximately £279,000,000, making, with the amount held in the Issue Department of the Bank of England as cover for the note issue, 76,843,000 fine ounces, 116,697,00 fine ounces, which at £7 per ounce, represented in round figures £815,000,000. At the same date the Account did not hold more than a trifling amount of foreign currency.

It is interesting to record the comment of the City Editor of *The Times* on this statement. Writing on December 30, 1937, he said—

"At £7 an ounce—to-day's price of gold was 139s. 6d.—the gold holding of the Exchange Account at September 30 would have been worth some £279,000,000 and that of the Bank of England £536,000,000. The previous and first statement of the Account, giving the position at March 31, showed that 26,674,000 fine ounces of gold were held in the

Fund, worth at £7 an ounce some £187,000,000. On the same date there was held in the Issue Department of the Bank of England 73,842,000 oz., or over £516,000,000 worth. The increase in the Account's holding during the six months to September 30 therefore was £92,000,000 and that in the Bank's gold reserve £20,000,000.

"The gold in the Bank is held as cover for the note issue, and the increase shown between March 31 and September 30 represents the equivalent at £7 an ounce of gold purchases made by the Bank at the statutory price of 85s. an ounce during the summer in order to offset the effect of the withdrawal of notes by foreigners for hoarding purposes. As well as a flight from the franc, the period also covered a flight from gold provoked by rumours of a possible revaluation of the dollar; the increase in the Exchange Account's gold testifies to the substantial purchases of gold on the bullion market made by the authorities in order to neutralize the effect of these capital movements.

"The present statutory size of the Account, including the additional £200,000,000 borrowing powers obtained in June, is £575,000,000, and it is clear that apart from its gold holding its free sterling assets must now be considerable. Since September 30 a certain repatriation of French capital may have reversed the inflow of gold, but there can be no doubt that the monetary reserves of the country in the Exchange Account and in the Bank are far larger than any previously held—as they should be since the amount of fugitive oversea capital known to be kept in London is also larger than ever before."

The actual working of the Exchange Equalization Account has always been a matter of conjecture, and therefore it is of importance to examine the opinion of one of the banks on this matter. For this purpose we reproduce an extract from a succinct account published by the Midland Bank, Ltd., in its Monthly Review of March, 1937.

In introducing the subject of Exchange Funds this review stated that by no means least among the inventions in monetary equipment since 1931 was the publicly-owned fund for regulating the foreign exchange value of a currency. Until recent years, governments took no direct part in the operations of the exchange market. Hence the new

invention represents a change in principle as well as technique, for the Exchange Fund, which is generally managed by the central bank, or in close association with it, actively intervenes in the market to restrict the fluctuations in rates within whatever limits the authorities may deem desirable from time to time. Then, after a few general observations on the British Exchange Equalization Account in its early stages, the review goes on to explain what are believed to be the broad principles regarding the mode of operation of the Account.

Reduced to the simplest possible statement the Midland Bank's review adds—

"It may be said that when foreign demands for sterling become inconveniently large, so that its exchange value tends to rise more strongly than is desirable, sterling is sold from the Account and foreign exchange or gold is bought, thus the holdings of Treasury bills or other sterling assets in the Account decline, and the holdings of gold and foreign exchange increase. Nowadays, moreover, to judge from the terms of the working agreements between the American, French, and British authorities, foreign exchange is almost immediately turned into gold, so that in these conditions the sterling assets of the Account fall and the gold holdings rise. When, on the other hand, sterling shows an unduly weak tendency, sterling is bought in the exchange market, and the gold holdings of the Account decline. Since, moreover, the Account will not wish to keep large quantities of sterling idle, it will presumably re-invest its newly acquired sterling in Treasury bills.

"It seems evident that, while on occasion the exchange value of sterling has been supported, the trend on balance over the whole period of nearly five years has been the other way, the Account has had to sell sterling in order to hold its value down in face of strong movements of capital out of other currencies into British pounds. Indeed, so strong has this trend been that apparently even the large resources already mentioned have proved inadequate. In carrying out its task the Account has come into possession of large quantities of gold, and from time to time it has handed gold over to the Bank of England, receiving sterling in payment therefor. For some years past there has been no particular reason why the Bank should wish to reinforce its

own gold reserves, which have been ample for statutory and psychological requirements and serve no practical purpose; hence the conclusion that the absorption of gold into the Bank has been mainly to serve the purposes of the Account. The gold taken over by the Bank, like that already held there, is entered in the weekly return at the statutory price of approximately 85s. per fine ounce, and it may therefore be deduced that the Account receives only that amount for the gold, which it bought at much higher prices, ranging up to and even above 140s. The difference between the two prices, one fixed and the other varying, is presumably carried in a suspense item on the assets side of the Account, pending extinction if and when the Bank of England's gold holding is revalued under any new statute which Parliament may enact By the process, then, of re-selling gold to the Bank the rigid limitation of the sterling resources available to the fund is removed.

"Much ink has been used in discussing, on indirect evidence and by hypothetical reasoning, the effects of the operations of the Account on the monetary situation. Obviously, when great movements take place across the exchanges these transactions must have a large effect on the volume of Treasury bills available in the market, and this in itself is a matter of great importance. But most of the discussion is concerned with the effect of the operations of the Account upon the cash basis for the banking system, and through it upon the total volume of bank deposits. Clearly, for example, a sale of Treasury bills from the Account to the Bank of England would increase the cash basis, just like any other purchase by the Bank of England; on the other hand, a sale of Treasury bills from the Account to the open market would not have this effect. The possibilities can be multiplied almost indefinitely but, inasmuch as the Bank itself operates the Account, the discussion is beside the point. Action taken by the Bank with resources belonging to the Account in no way modifies the Bank's responsibility for controlling the size of the cash basis, for the Bank can co-ordinate its own operations and those it undertakes for the Account, and by so doing can enlarge or contract or stabilize the cash basis as general considerations require.

"One minor qualification of this statement should be noted. Absorptions of gold by the Bank from the Account, unless counterbalanced by an increased circulation of notes, can be offset in their effect upon the cash basis

only by the sale of some of the earning assets in the Banking Department of the Bank, and this is a course which cannot be pursued indefinitely. This fact, however, does not restrict the Bank's capacity to absorb gold from the Account. As we saw last December, the Fiduciary Issue of notes can be reduced as gold is absorbed, the effect being that the earning assets of the Issue Department, the profits of which go to the Treasury, are reduced, while the earning assets of the Banking Department are unchanged. Treasury permission is required for this procedure, but the conclusion already stated is none the less true: that the operation of the Account, since it is worked by the Bank of England itself, does not impair the central bank's powers and responsibility for governing the cash basis of the banking system. On the contrary, since by means of the Account the resources for active intervention in the exchange and money markets are greatly increased, and since, moreover, intervention does not betray itself in any published figures, the Bank of England's powers are on balance increased."

CHAPTER XIII

THE LONDON GOLD AND SILVER MARKETS

METHODS of quoting gold—The American and French parity price calculations—The open bullion market—The Indian gold flow to London and other countries—The silver market quotations—How the silver market works—The heavy fall in the price of silver and the effects

NOT the least important sections of the London Money Market are the gold and silver markets: we apply the word "market" in the general sense as including any body of persons who have a commodity to buy or to sell. As being the more important, let us take the market for gold first.

British Standard for Gold.

The British standard for gold is $\frac{11}{12}$ths, or ·91667 fine. That is to say, in each 1,000 ounces of standard gold there must be eleven parts pure gold to one of alloy; or, to put it still another way, each 1,000 ounces of standard metal must contain 916$\frac{2}{3}$rd ounces of pure or fine gold and 83$\frac{1}{3}$rd ounces of alloy. This, of course, is the same standard fineness as that of the British sovereign and half-sovereign. The English standard is the old one of 22 carats in 24, that is to say, the sovereign must be made of metal of which 22 parts are pure gold and 2 parts alloy. It is the same as the $\frac{11}{12}$th fine quality. France, the United States, and most other nations use the $\frac{9}{10}$th fine quality, or, as they usually call it, 900 parts fine gold to 100 parts of alloy or copper. The system of expressing the quality of gold in millièmes, taking 1,000 fine as the absolutely chemically pure gold, is now generally adhered to. The Bank of England uses it instead of the former carat method; but as the 22 carat fine carries a fraction in decimals, the British standard is called 916$\frac{2}{3}$rds fine. British gold coin is, therefore, about 2 per cent finer, or more valuable, than

the 900 fine coin, but that makes no difference in the account. The gold alone is paid for; the alloy, usually copper, is used merely to make the coin harder, and it is considered that the 900 fine quality wears better than our standard. As a matter of interest, it might be noted that the additional copper in the 900 fine coin is worth less than the one-thousandth part of a penny per coin.

Methods of Quoting.

However, the old method of quoting gold bullion, which even to-day is often reverted to by the jewellers, is one of those perplexing curiosities that have survived from the days of the goldsmith bankers, who used to quote gold at so much " betterness " or " worseness," as the case may be This method of calculating, as we have said, lays down that pure gold should be taken as 24 carats fine and standard gold 22 carats fine, the sub-division of the carat in grains being—

8 eighths = 1 grain
4 grains = 1 carat
24 carats = 1 ounce

So, if we take standard gold as 22 carats, then gold would be quoted at so many carats, grains, and eighths " better " or " worse " than standard gold.

This method, however, is rather archaic, and the more modern practice, even among jewellers who have to deal in small quantities of gold, is to take the carat as being 10 dwt. and to calculate the " betterness " or " worseness " as follows

Calculations Analysed.

If 24 carats of 10 dwt. each are the equivalent of pure gold, then 240 dwt. pure gold, that is, 1,000 fine less 20 dwt., is equal to 220 dwt. standard gold (i.e. 916⅔rds fine).

To describe gold as 10 " betterness " is equivalent to saying that it is 10 dwt. " better than " standard gold,

and on this basis the gold would be $220 + 10 = 230$ fine, and thus we get the following calculation—

$$240 : 230 :: 1000 : x$$

and $x = \cdot 958333$ fine.

In the same way we can calculate the fineness of a bar quoted so much "worse"; for instance, 12 "worseness" would be $220 - 12 = 208$ fine, and the calculation is—

$$240 : 208 :: 1000 : x$$

and $x = \cdot 8667$ fine.

Gold it seems needless to say, is weighed according to troy weight, the divisions being—

1 pound troy	= 12 oz. troy
1 oz. troy	= 20 dwt. troy
1 dwt. troy	= 24 grains troy

Mint Price of Gold.

Under the English Coinage Act, 1869 sovereigns are coined from 40 lb. troy, and on this basis is calculated the Mint price of gold, to which we have referred in previous chapters, viz.—

If 1,869 sovereigns equal 37,380 shillings, and 40 lb. troy equal 480 oz. troy, then 1 oz. troy equals $\frac{37380}{480}$ $= 77\,875$ shillings, or 77s. 10½d., which is the Mint price of gold

The Royal Mint, as we have pointed out in Chapter VII, does not receive unrefined gold When imported gold was sent to the Mint, before the suspension of the Gold Standard, it was received and paid for on the basis of conversion into sovereigns or half-sovereigns at the rate of £3 17s. 10½d. per standard ounce free of charge Under the provisions of the Gold Standard Act, 1925, bankers and others who import gold bullion cannot now tender it to the Royal Mint for coinage The Bank of England, however, always stood ready to buy gold tendered to it at £3 17s. 9d. per standard ounce. The loss of 1½d. over the Mint price per standard

ounce, in effect, represented the Bank's charge for loss of interest and other expenses incidental to passing the metal through the Mint for coinage. With the open market price of gold soaring to record prices in 1932, no one of course would tender gold to the Bank for purchase at the statutory price. Even prior to the suspension of the Gold Standard, neither the Bank of England nor the Royal Mint, however, bought all the gold imported; a good deal of it was taken for India, the Continent, the United States of America, and other countries.

Imported Gold.

The gold which is bought and sold on the London market is usually in the form of refined bars or ingots, weighing about 400 oz. each. Each bar must contain a minimum of 99 per cent. pure gold and, as a rule, bars contain rather more than less this percentage of gold, those usually bought and sold being nearer 99½ per cent pure. Gold, it should be noted, is weighed down to ·025 of an ounce troy, and bars assaying ·995 fine or over, and containing between 350 and 430 oz. of fine gold and bearing the stamp of a recognized assayer, are good delivery. Coin bars, i e. bars assaying 899 to 901 per mille or 915½ to 917 per mille and containing between 350 and 430 oz. of fine gold are also good delivery, provided they bear the stamp of one of the recognized assayers. Unrefined gold is weighed down to ·050 of an ounce troy. Bars weighing less than 350 to 400 oz. are often bought and sold for such places as Bombay, but in that case a small extra charge per ounce is added to cover the cost of manufacture.

Dealings in gold bullion on the London market before the War were on the basis of standard gold, but for some years the quotation has been for fine gold, for reasons to which we shall presently refer. The price is fixed daily by Messrs. N. M. Rothschild & Sons, in consultation with the London bullion brokers, who meet at the office of this famous firm of private bankers at 11.15 a.m. Although

all gold transactions with the Bank of England are on the basis of ounces standard, in the open market gold is now bought only on the basis of fine ounces, i e. pure gold. In this connection, we may mention that the Bank of England's buying price of 77s. 9d per ounce standard is equivalent to 84s 9·8181d. per ounce fine, while the Bank's selling price of 77s 10½d. equals 84s. 11·4545d per ounce fine.

Cash Price.

Until the year 1930 it was generally understood that there was only one market price for gold, that was the "Cash" price Forward contracts, as a rule, were not entered into on the gold market, and no "future" or "forward" price was quoted. In the "scramble" for gold in the year in question, however, France came into the London market prepared to buy quantities of the Cape gold forward, and contracts were made for certain amounts to be delivered at given periods, the price being that fixed on the day of delivery. This was an innovation for the London market, as previously a broker was entitled to his money on the day of purchase immediately he presented his contract. The fact remains, however, that there is still only one price given out daily, and that is the cash price per ounce of fine gold.

The brokerage charged on purchases of bar gold in London is now ¼ per thousand, minimum £25.

In June, 1930, the market was keenly interested in a change of policy by the Bank of England. There had been heavy demands upon the Bank for gold, principally from France, and during the second week of June it was announced that the bar gold to be delivered to buyers of gold from the Bank would be of a fineness of ·9166, that is, standard fineness instead of fine gold as previously delivered. This change in the Bank of England's practice regarding the fineness of the gold bars it sells, involved no departure from the strict letter of the law The Bank of England,

as a matter of fact, is not limited necessarily even to the delivery of bars of standard fineness, since the Gold Standard Act of 1925 imposes no restrictions on the delivery of bars of lower quality.

The immediate effect of this alteration was seen in the market price of gold. Gold of a fineness of ·9166 was unacceptable to the Bank of France, and any such metal bought from the Bank of England had to be refined up to ·995. This involved the loss of one day's interest and a charge of ¾d. per ounce gross for refining, consequently, the South African gold sold on the London market on June 10, 1930, fetched 85s. ⅜d. per fine ounce, the premium of ⅞d. over the Bank's selling price of 84s. 11½d., being the equivalent of the refining and interest charges. In January, 1931, however, it was announced to the London Gold Market that the Bank of France had decided to accept bars of the English standard of fineness, ·9166, as delivered by the Bank of England. Under this arrangement refining was no longer necessary, and from January 16, 1931, gold of that standard was acceptable both to France and some of the other principal Continental buyers.

American Parity Price of Gold.

When gold dealing and shipping was resumed after the War, the London market evolved what was known as the "American Parity Price."

The method adopted was for the parties interested to compare the amount of gold which each had to buy or to sell, as the case may be, and the price was then fixed on the basis of the London–New York rate of exchange, or the "Cross-rate," as it was called in market parlance.

It seems curious to measure the market value of gold by the movements in the London–New York cross rate of exchange, but we need not go far to seek a reason. Before the War the pound sterling was maintained at or near its Mint par of exchange with Gold Standard countries, and the price of gold bullion did not vary much above or below

the fixed Mint price of 77s. 10½d. The position with which the London gold market was faced at the end of the War, arose from the fact that the pound sterling, measured in terms of gold, had heavily depreciated, mainly owing to the over-issue of paper money during and after the War. Further, as will be seen from a study of the Gold and Silver (Export Control) Act, 1920 (Appendix III) the export of gold from England was restricted. Consequently, although the sterling price of gold was still regularly quoted in London, it had become necessary to calculate what that price should be on the basis of the monetary unit of the country in which there was then still a free gold market—the United States of America. Gold had flowed into the United States in considerable quantities from all parts of the world, and the main reason was that the balance of international indebtedness had been favourable to the United States—she had, so to speak, held the rest of the world in fee. In consequence, the American dollar remained at par with gold and was interchangeable with it; but the monetary units of other countries having depreciated in a varying degree, had lost a larger proportion of their purchasing power than had the monetary unit of the U.S.A.

These, in brief, were the reasons for the price of gold being practically determined by the dollar exchange for sterling, and in treating this exchange as a sort of index number of the price of gold, dealers worked on the following basis—

The American gold eagle (or ten dollar piece) contained 232·2 grains of fine gold, so one American dollar contained 23·22 grains, and, to take an example, if the American exchange be quoted at, say, \$4·35⅜ for £1, then by chain rule we get the following equation—

? Shillings	equal	1 oz (480 grains fine) gold
If 23 22 grains fine	,,	\$1
,, \$ 4 35⅜	,,	20 shillings

$$= \frac{480 \times 20}{23{\cdot}22 \times 4{\cdot}35375} = 94s\ 11{\cdot}5323d. \text{ per 1 ounce fine gold}$$

The same result could have been arrived at in another way, that is, by basing the calculation on the Mint price of gold in the United States, which was \$20·67183 per ounce fine—

If the U.S. Mint price of gold was \$ 20·67183, then

x shillings	equal	1 oz. fine gold
1 oz. fine gold	,,	\$ 20·67183
\$ 4·35⅜	,,	20 shillings

$$= \frac{20{\cdot}67183 \times 20}{4{\cdot}35375} = 94{\cdot}961 \text{ shillings} = 94\text{s. } 11{\cdot}532\text{d.}$$

The result in each case represented the "gross" price; to arrive at the "net" quotation there had to be deducted a small amount representing expenses for shipment, loss of interest, and cost of realization of the gold when it arrived in New York. The resultant figure was the fixed price which was given out daily to the market (except Saturdays, when there was no market) as the American parity quotation for gold.

It did not follow, however, that the price at which dealings took place were always worked out exactly on this parity: if demand were keen, the sterling price was sometimes a little higher than the American parity price. Generally speaking, there was a premium on gold over the American parity price when the demand was other than for the U S A. If, on the other hand, supplies were large, as evidenced by the arrivals of gold from the main source of supply, South Africa, the price fixed used to be approximately equivalent to the American parity.

This method of fixing the daily price of gold in London came to an end with the coming into force of the Gold Standard Act, 1925 (15 & 16 Geo. V), on May 13, 1925, and thereafter until the suspension of the Gold Standard on September 21, 1931, the price quoted was determined by the ordinary rules of demand and supply, without regard to the U.S.A. or any other rate of exchange.

With the country off the Gold Standard the open market

has reverted to the method by which the price of gold is governed by movements in rates of exchange with the remaining Gold Standard centres, but before explaining the computations we may refer to one or two points in the Gold Standard Act of 1925 and the Currency and Bank Notes Act of 1928, so far as they concern the gold market. The former Act placed England on the Gold Bullion Standard, in lieu of the Gold Specie Standard that had been in force in the country up to the Great War. For the effective working of the Gold Bullion Standard, there must be an obligation on the Central Bank to buy and to sell gold bullion without restriction at prices fixed by law. Thus, the Bank Charter Act of 1844 imposes on the Bank of England the obligation to buy gold at 77s. 9d. per ounce standard (equivalent to 84s. 9·8181d per ounce fine), while the Gold Standard *Act of 1925 made it obligatory to sell gold bullion, at its* Head Office, to all comers, at the price of 77s. 10½d. per ounce standard (84s. 11·4545d. per ounce fine), though only in the form of bars containing approximately 400 ounces troy of fine (or pure) gold

The Act of 1925 suspended both the free coinage of gold and also the convertibility into gold coin of currency notes and Bank of England notes

In practice, no one outside the Bank of England ever took bar gold to the Royal Mint for coinage into sovereigns, the business was arranged with the Bank of England But the Gold Standard Act of 1925 definitely put an end to the existing right Sect 1 (*c*) reads—

"Section eight of the Coinage Act 1870 (which entitles any person bringing gold bullion to the Mint to have it assayed, coined and delivered to him) shall, except as respects gold bullion brought to the Mint by the Bank of England, cease to have effect."

The restoration of the Gold Standard in England was achieved in May, 1925, and, although not on all fours with the standard that had been in force before the War, it will be realized that the Gold Bullion Standard is more scientific

and more economic than the Gold Specie Standard, which calls for the free circulation of gold coins. Further, the Act of 1925 ensured for Great Britain the free convertibility of gold into credit and credit into gold. By limiting the sales of gold to bars of a minimum weight of 400 oz. the circulation of gold for internal use was effectually prevented.

We have referred at length to the Currency and Bank Notes Act, 1928, in Chapter IV, but may add here that convertibility into gold in accordance with the Gold Standard Act of 1925 was maintained by the later Act of 1928 As far as the London gold market is concerned, Section 11 of the Currency and Bank Notes Act, 1928, is important This Section was framed for the purpose of ensuring the concentration of the gold reserves of the country in the hands of the Bank of England. The effect is to entitle the Bank to buy compulsorily any holding of gold coin or bullion in excess of £10,000, with the important exception of gold "which is *bona fide* held for immediate export or which is *bona fide* required for industrial purposes" This exception was devised in order to leave the activities of the London bullion market entirely untouched. The Gold Standard (Amendment) Act, 1931, also leaves unfettered the purchases and sales of gold in the open market, but it relieves the Bank of England from the obligation to sell gold bullion at the statutory price.

All three Acts are printed in the Appendices to this book: they will repay careful study by readers.

Market's Method of Calculating Price of Gold.

To return to the open market's method of calculating the price of bar gold in London. After the suspension of the Gold Standard in September, 1931, the system adopted to find the parity price was similar to that followed during the War, but as France and the Netherlands, as well as the United States of America, remained on the Gold Standard,

in practice this calculation was based on whichever rate of exchange was the most adverse to London when the gold was available for sale. The following examples—one taken from the American Exchange and one from the French—will give the reader a clear idea of the method followed.

1. *American parity price of bar gold in London, based on a given rate of exchange for the pound sterling with New York.*

As stated in the example given on page 211, the United States Mint buying price for gold was \$20.67183 per ounce troy of fine gold, but, as mentioned, to get the exact price the charges had to be taken into account. The practice, then, was to deduct the expenses entailed in shipping gold to New York, viz. freight, insurance, loss of interest, packing, petty expenses, U.S.A. Mint charges and loss in melting, handling commission in New York. These were estimated to amount to approximately 4·2775 per mille. After this deduction from the Mint price it was necessary to multiply the result by 240 and then divide by the rate of exchange of the day, the result was the sterling price for bar gold in London in pence per ounce of fine gold.

For example, suppose the exchange with New York on a given day were \$3.30 to £1—

$$
\begin{aligned}
& & 20{\cdot}67183 \\
\textit{Less } 4{\cdot}2775 \text{ per mille} & = & {\cdot}08842 \\
& & \overline{20{\cdot}58341} \\
\frac{20{\cdot}58341 \times 240}{3{\cdot}30} & = & 1{,}496{\cdot}975 \text{ pence} \\
& = & 124\text{s. } 8{\cdot}975\text{d.}
\end{aligned}
$$

per ounce of fine gold.

It may be noted that in this calculation 10 days' interest at 1 per cent was allowed, but the interest was less if the gold were sent by a faster steamer at the time of the operation.

2. *French parity price of bar gold in London, based on a given rate of exchange for the pound sterling with Paris.*

The Bank of France's buying price for bar gold is Fcs. 16,919·084 per fine kilogramme, so it will be necessary to

divide this by 32·150725, which will give the equivalent number of francs per ounce troy of fine gold. Then, as in our other computation, we must deduct the expenses of sending gold to Paris, viz. freight, insurance, French customs charge, packing, petty expenses, assay charge in Paris, and handling commission, etc. These were approximately 1·3065 per mille. Then we multiply the result by 240 and divide by the rate of exchange, which gives the equivalent sterling price of bar gold in London, expressed in pence per ounce of fine gold.

For example, suppose exchange with Paris on a given day was 84¼ francs to £1—

$$\frac{16{,}919{\cdot}084}{32{\cdot}150725} = 526{\cdot}242689$$

$$\textit{Less } 1{\cdot}3065 \text{ per mille} = \quad {\cdot}687536$$

$$525{\cdot}555153$$

$$\frac{525{\cdot}555153 \times 240}{84{\cdot}25} = 1497{\cdot}13\text{d.}$$

$$= 124\text{s. } 9{\cdot}13\text{d.}$$

per ounce of fine gold in London.

In recent years nothing like finality seems to have been reached in these matters, and in 1933 a further change took place. On April 19, 1933, the Gold Standard was suspended in the United States of America. Then on January 29, 1934, the U.S.A. adopted the Gold Bullion Standard, and at the same time reduced the gold in the dollar to 59·06 per cent of its former content. The dollar, therefore, now contains only 13·713732 grains of fine gold.

It was at the same time announced that henceforward the U.S. Treasury would pay $35 per fine ounce for all gold tendered to it from whatever source, less the usual Mint charges and less ¼ per cent for handling charges.

However, in 1937 the U.S.A. was practically the only country on a free gold standard, and the bulk of the world's gold continued to be taken by her. In the circumstances,

the London market price had perforce to be based on the American parity, and operators adopted the following simplified calculation to arrive at the daily price—

Given the U.S.A. Treasury price of \$35 per fine ounce and an exchange with New York of, say, \$4·994 to the £1, then

$$\frac{35}{4{\cdot}994} = £7{\cdot}008$$

This is the gross price, from which has to be deducted U.S. charge of ¼ per cent for handling, and shipping charges ⅜ per cent

$$\begin{array}{lll} & & 7{\cdot}008 \\ \textit{Less} & {\cdot}25\% & \\ \text{,,} & {\cdot}325\% & \\ \hline & {\cdot}625\% = & {\cdot}04380 \\ \hline & & 6{\cdot}9642 = 139\ 3\tfrac{1}{2}\text{d.} \end{array}$$

per fine ounce.

Each day there appears in the Press the fixed gold quotation, and a statement usually follows to the effect that the price includes a greater or less premium over the American parity price. The premium varies from day to day according to demand and supply, and represents approximately what buyers are willing to pay over the American parity price as above calculated. The greater the supply, the less the premium, the smaller the supply and the greater the demand, the wider will be the divergence over the parity price.

South African Methods of Marketing.

It is rather important to know the exact procedure as regards the sale in London of gold from South Africa, the most important producing country, and, at the risk of some reiteration, we give an extract from the information

published by the Imperial Mineral Resources Bureau, showing the method of disposing of the gold in London.[1]

The gold, as received in London from South Africa, is of comparatively low fineness, and before being sold by auction it is refined by the producers' agents to a purity of ·999. With the exception of small amounts for use in the arts bid for at a price higher than the level of the New York dollar exchange rate, as mentioned above, the whole of the gold offered was ordinarily bought in by the agents at that rate, allowance being made, as we have said, for expenses of shipment to New York, insurance, and commissions in London and New York. A slight margin, sufficient to cover these charges, was frequently shown between the daily quotation of gold in London and the dollar exchange rate. As the net result of the sale, the South African producers received dollar exchange to the amount of \$20·67 per ounce of fine gold purchased (this representing its Mint value in the United States) less the cost of transportation from South Africa to London and the charges above mentioned.

The arrangements for the disposal of gold produced in the Transvaal are detailed in a statement, dated Johannesburg, September 2, 1919, on page 251 of the *Report of the Transvaal Chamber of Mines* for that year—

Before the War, the producers shipped their gold to London and sold it to refiners at 77s. 9d. per standard ounce (i.e. per ounce of bullion having a fineness of 916·66), delivery being taken by the purchasers in London.

At the outbreak of the War, an arrangement was made between the Union Government, the Bank of England, the South African banks, and the gold-mining companies, by which the Bank of England purchased and took delivery of the gold in South Africa at 77s 9d. per standard ounce, advancing 97 per cent., and subsequently $98\frac{3}{4}$ per cent. of the purchase price against delivery of the gold,

[1] *Cf. Mineral Industry of the British Empire and Foreign Countries* (p 9 *et seq.*).

the balance being adjusted later. Although delivery was taken in South Africa, the producers were required to bear the cost of insurance and freight, amounting approximately to 25s. per cent.

On July 24, 1919, a new arrangement was entered into between the Bank of England, the Union Government, and the gold producers, as a result of which the gold producers, members of the Transvaal Chamber of Mines, ship all gold, refined and unrefined, produced by them, consigned to the Bank of England, with the exception of such amount as may be needed to meet local currency requirements. On arrival at the Bank of England, unrefined gold is delivered to the refiners of the gold producers. The sale of the refined metal (including gold refined after arrival in London) is negotiated by the producers' agents, Messrs. N. M Rothschild & Sons. The agents sell the gold at the best price obtainable, and they afford the London market, represented by the bullion brokers, and the trade an opportunity for bidding.

All charges for freight, insurance, refining, assaying, and expenses in connection with the marketing of gold are borne by the producers. There is a further provision by which the Bank of England undertakes to advance an amount equal to 77s. per standard ounce subject to interest. The gold producers, however, have not availed themselves of this provision, but have entered into other arrangements. This arrangement with the Bank of England was originally subject to termination of six months' notice on either side; but at the Annual Meeting of the Transvaal Chamber of Mines, held on March 22, 1920, it was stated that the agreement had been amended and made terminable on three months' notice.

The Indian Exports of Gold.

There remains to be noticed the phenomenal export of gold from India that has taken place since the suspension of the Gold Standard by Great Britain.

India, in past years, has been an outstanding factor in the absorption of gold, but, following the suspension of the Gold Standard in Great Britain in September, 1931, the position was reversed and gold commenced to be exported in increasing quantities. The release of both the pound sterling and the rupee from their gold mooring, as has been previously stated, caused a high premium on gold to be reached, and as this premium increased with the depreciation in sterling, so the export of gold has continued to grow in volume. In this connection, the comment by a writer in *The Times of India* is illuminating, and we paraphrase his remarks. He said it is only natural that the small holders, who must be legion, should want to realize a profit on their small hoarded savings in the form of gold. In view of the fact that a very large number of up-country dealers do business in Bombay through many different agents, it is very difficult to discover the source of the arrivals, but it is reported in the bazaar that probably the majority of arrivals are derived from Madras, Rangoon, and the Deccan in particular, and the South generally. However, it is probable that most other parts of India are also contributing their quota. It is the easiest thing for the up-country dealer, who is also in many cases a bullion dealer and shroff, to melt his clients' gold ornaments and so make a convenient homogeneous ingot for disposal in the bazaars of the large ports like Calcutta and Bombay When these ingots, large and small, arrive in Bombay, they are handled mostly by the bigger shroffs and wholesale bullion dealers, who send them into the Mint at Bombay to be refined, assayed, and moulded into convenient bars, and stamped with the name of the mint and a number. The bars are then exported.

Various fantastic estimates of the sum total of the gold exported have been given from time to time, but from careful statistics kept in London, the actual value of the gold so exported from September 21, 1931, to January 14, 1937, is known to be £237,615,000.

The gold usually arrives in London each Friday. It is then assayed by the recognized London assayers, and, where necessary, made up into marketable bars. The gold is offered for sale on the London market on the following Monday, and is sold at the price of the day, on the basis previously described. The rapidity with which this gold is collected from the steamers, conveyed to the London refineries, assayed, and sold, shows that the London bullion market holds pride of place in its disposal of the precious metal. Not all the gold so dealt with is retained in London, a great deal of it, after sale, is immediately dispatched by the purchasers to the Continent by air transport, and large amounts are also re-exported to the United States by steamer. It will be realized that these gold exports from India have contributed in no small degree in the maintenance of the exchanges on London.

Then, again, the gold movement has been of inestimable value to India itself. It has enabled the Government to remit large sums to England, and thus to obtain sufficient sterling to meet its home charges, as well as to pay off a good deal of maturing indebtedness. However, so widespread has been the attention given to the export of gold from India, especially in regard to its international aspects, that attention may be drawn to the remarks of high Indian officials on the subject. The details given below, it may be added, deal more particularly with the significance of these gold exports in relation to the economic and financial position of India itself. What really are the facts?

In his address to the Members of the Indian Legislative Assembly, delivered on January 25, 1932, the Viceroy of India outlined the position in this way. Those who sell gold do so because they can make a profit on their holdings.

They have made an investment which has turned out well. Why should they be deprived of the opportunity to take advantage of it? He said: "There is no public ground on which this could be justified, for the export of gold at that stage was definitely and decisively to India's

advantage." Most countries who, like India, rely on primary agricultural products for maintaining their balance of international trade and payments, are now labouring under acute difficulties, which force them to adopt extremely stringent measures for the control of exchange which greatly hamper the commerce of the country. At such a time India is able to tap a portion of her own vast resources, and by parting with a very small fraction of her immeasurable stores of gold to realize a favourable balance of international payments. The Viceroy further points out that the good results of this were already apparent—Indian exchange was strengthened, the Bank Rate was eased, and the accumulation of sterling resources enabled India to pay off £15 millions sterling without borrowing, thus relieving the country of a capital charge of Rs. 20 crores, and a recurrent charge of Rs. 110 lakhs per annum. The amounts exported are negligible in relation to India's total holding of gold. What the total holding may be no one knows; but the Viceroy reminded the Legislative Assembly that India's net imports of gold during the last 30 years alone amounted to no less than 550 crores worth, as valued at the time of import, or well over 700 crores if re-valued at the prices ruling in 1932. Against this, exports since September, 1931, to January, 1932, amounted in value to no more than 40 crores at the prices then current. It will be realized that this volume is of no appreciable importance compared with what has been imported into India in recent years alone, and without taking account of the vast stores which must have been accumulated before 1900.

Finally, the Viceroy said that the export of gold is no new feature in India's commercial life. Large quantities have always moved in and out, and on special occasions India has tended to realize gold as a means of adjusting the balance of payments, or in order to take advantage of profitable opportunities of selling gold against rupees. It is plain that the export of gold from India in 1931–32 has been of great benefit to both public and private interests, and goes to

prove that there are at least some occasions in an economic cycle when India's ancient tradition of investment in gold can prove to be of direct economic advantage to the country.

In his Budget Speech on March 7, 1932, the Finance Member of the Government of India also drew attention to the popular misapprehension of the significance of what was happening. He corrected it in these words—

"The phenomena of the last few months should not be viewed by themselves, but as one phase in a process of many years India requires a certain flow of exports to balance her imports of merchandise and external payments. In the past few years the volume of this flow has been more than is required, and has been stored up, as in a reservoir, by being put into gold. Now that the volume has shrunken owing to the immense fall in the prices of India's exports (a fall which has been far greater proportionately than for India's imports) the flow is being supplemented by drawing to a moderate extent on the reservoir of gold. Thus the 'reservoir' is performing exactly its proper function of equalizing the flow, while the quantities being drawn off are negligible in comparison with the quantities stored."[1]

NOTE 1 rupee, 1s 6d., 1 lakh of rupees, a hundred thousand rupees, £7,500. 1 crore of rupees, a hundred lakhs, £750,000.

THE LONDON SILVER MARKET

British Standard for Silver.

Then we have the London silver market.

Silver, according to the British standard, is $\frac{37}{40}$ths fine, or, as it is expressed on the market, ·925 fine, which means that in every 1,000 ounces of silver there should be 925 ounces of the pure metal and 75 ounces of alloy. Silver is weighed down to ·25 of an ounce, and ·996 is good delivery.

[1] Further facts are given at length on the Indian gold position in the Author's *Foreign Exchange and Foreign Bills* and a *Money Manual*, Vol II (London. Sir Isaac Pitman & Sons, Ltd)

Calculations.

As with gold, we sometimes meet the old terms, "betterness" and "worseness"; and, on the same principles we have enunciated in respect of gold, if 24 carats of 10 dwt. equal pure silver, then 240 dwt. less 18 dwt. equals 222 dwt., which is the equivalent of standard silver, that is, ·925 fine. The "betterness" with which one used frequently to meet in dealing with silver was 17½, so, taking standard silver as 222 dwt., then $222 + 17{\cdot}5 = 239{\cdot}5$, from which we get such equations as the following—

$$240 : 239{\cdot}5 :: 1000 : x$$

and $x = 997{\cdot}9$, or, in other words, 17½ betterness in silver means 997·9 fine. Except among some of the jewellers, this method of working is now out of date, and we refer to it merely as a matter of general interest.

Coinage Act, 1920.

Lest any misapprehension should take place, we hasten to say that under the Coinage Act, 1920 (it will be found in full in Appendix II), British silver coins are now only one-half fine silver and one-half alloy, or millesimal fineness 500. They were debased from $\frac{37}{40}$ths fine silver, $\frac{3}{40}$ths alloy, or millesimal fineness 925, to 500 millesimal fineness on March 31, 1920. Transactions in silver bullion on the London market, however, still take place on the basis of ·925 fine.

London Dealings in Silver.

Silver dealings in London are all on the basis of the standard ounce, and the price is quoted at so many pence and fractions of a penny per standard ounce, not in shillings and pence per fine ounce as with gold.

London is the world's silver market, and the business in it is carried on rather differently from that seen in the gold market.

The reasons for London's occupying the enviable position of the world's market are twofold In the first place,

London has the lion's share of the Far Eastern trade. India, and practically all Eastern countries, are users of silver; and, although a number of them are on the gold standard, or something approaching to it, to wit, the Gold Exchange Standard, yet silver is a power all over the East, and the dealings in it, both as a commodity and as a medium of exchange, are immense. All the Indian and Eastern banks have large branches in London, and as these are the principal intermediaries for the mercantile trade of the East, there is little wonder that London remains the most important market for the silver used.

Apart from this, geographically London is a convenient centre for supplying the wants of European nations in the matter of coinage.

The other reason for London's pre-eminence is this. America and Mexico, whence the greater part of the white metal emanates, might not unreasonably have expected to deal direct with Eastern nations instead of sending their silver to London, and, truth to tell, a certain amount of silver does find its way direct to the East from San Francisco and, in a lesser degree, from New York; but as compared with the proportion shipped from London the quota is small. Formerly, silver produced in the U.S.A. and contiguous countries was received in London in regular weekly shipments America now retains the metal for her own monetary use Apart from that, in London there is always a market for the world's silver production; and the brokers usually have instructions to sell the metal, on or before arrival, at the best price obtainable. Actually, the smelters in America buy silver ore from the mines in so many ton lots, usually about 1,000 tons at a time; and as each ton is computed to contain approximately 20 ozs. of silver, the custom is to sell the metal on that basis upon the same day as the ore is bought from the mines. Most of the smelters sell, for every 1,000 tons they buy, 20,000 ozs. of silver to be delivered in two months. If the seller at the date

of maturity has not sufficient of the metal to fill the contract, he has to buy it in from some other source in order to make up the 20,000 ozs., or whatever amount it is that he has sold; and in that case he will sell a similar quantity for forward delivery another two months hence. As a matter of fact, this buying ready and selling forward is carried on pretty extensively in the silver world.

"Fixing" the Silver Prices.

As London has the handling of the bulk of the silver produced, it follows that it is London which calls the tune and "fixes" the price for the whole world. "Fixing," so called, is under the control of four reputable firms of London bullion brokers, who meet daily at 1 45 p.m., except on Saturday, when they meet at 11.30 a.m.

At the daily meeting, the brokers compare the amount of silver each has to buy or to sell, and they then fix a price at which operations are to be put through, and this price goes out to the public as the quotation for the day. Immediately it is known, the Eastern banks and others get busy with the wires, and they telegraph out the price of silver to their respective branches and clients all over the world. If there are more sellers than buyers, the quotation is marked down; if buyers predominate, the price is put up; and if demand and supply are about equal, the price is marked "unchanged" from that of the previous day.

"Ready" and "Forward" Prices.

We have said "price"; but, in practice, except during the War, when only one quotation, that for cash, ruled, there are two prices given out to the market: one called "ready," and the other "forward."

The "ready," or, as some brokers call it, the "spot" quotation, is for silver, cash against delivery within one week, or earlier, if the seller elects to deliver it. Special

arrangements can, of course, be made for later delivery if desired. The "forward" quotation represents silver deliverable in two months from date of purchase. There are no days of grace, or anything of that sort for "forward" silver; the seller is bound to deliver and the buyer to pay for the metal exactly two months from date of contract. If for any reason the buyer does not desire to take up the silver under a "forward" contract, he must give the broker notice in good time before the due date to sell it, and the difference, if any, is then settled on the maturity of the first contract. If the price has fallen, the buyer would have a certain amount to pay the broker for the difference; if the price has risen, it is the broker who has to pay a difference.

Eastern banks and others purchasing silver in London were formerly charged a brokerage of ⅛ per cent. In June, 1930, following a long period of depression in the price of silver, the London bullion brokers gave notice of their decision to charge a brokerage of 11s for each 5,000 ounces standard or part thereof, so long as the price of silver does not exceed 21d per ounce standard. This new arrangement came into force on July 1, 1930. The minimum brokerage on silver purchases is £1. No brokerage is charged for selling silver on the London market.

A "Budla" Operation.

There is another practice in the silver market which is sometimes witnessed in connection with covering operations on account of the silver standard countries of the East. Silver is sold ready and bought forward, or *vice versa*. In the East it is called a "Budla," or "Budlee," operation, and the term is sometimes used in London, though the writer has heard the operation termed a "put and take" deal. As it happens, sometimes there is a kind of option business carried on in silver by the speculators: it is known as "calling" and "putting," the charge for which is about 2 per cent. on the value of

the silver for which the option is taken, and, in addition, the buyer is charged the usual brokerage on the option. It is not a business which is encouraged, and bankers of repute steadfastly set their face against such deals.

"Premium" and "Discount."

There remain to be explained the terms "premium" and "discount." To say that "silver is at a premium" or "silver is at a discount" is to make use of one of those indefinite expressions which are so puzzling to the person outside market circles. The expression should be "there is a premium (or discount) on spot silver (or forward silver)." It arises in this way: if the price of silver for cash be, say, 18d. per standard ounce, and that for forward silver 18⅛d., then cash (or spot) silver would be at a discount, while forward silver would be at a premium. If, on the other hand, forward silver is at, say, 18d. and cash silver 18⅛d., then cash silver would be at a premium as compared with the forward price.

Conditions for Dealing in Silver

The following conditions for dealing in silver were agreed by the London Bullion Market in February, 1936—

GENERAL.

1. The following are the conditions under which business in silver is normally transacted in the London Bullion Market.

2. By giving an order to or accepting a contract from a London Broker, the client accepts the terms of these conditions.

3. The Broker does not pass names or act or contract as Agent. His contracts are Principals' Contracts, but he charges brokerage on all silver purchased from him.

4. A Broker is at liberty to accept or refuse any order and is under no obligation to execute orders received by him.

QUOTATIONS.

5. The official prices are "fixed" once daily; there are two quotations, one for cash (or "spot") delivery—that is, delivery within seven days from the date of the contract at

the option of the seller—and one for two months' delivery, which is for delivery on a fixed date two calendar months from the date of the contract (Sunday contracts maturing on a Saturday). Although the only official quotations are for spot and two months' delivery, business may generally be freely transacted for intermediate and more distant periods.

6. Prices are quoted in pence per ounce standard (925/1000) and the ounce standard is the unit of accountancy in the London Market.

7. The London Brokers meet for fixing at 1.45 p.m. (Saturdays 11.30 a.m. when the market is open). Orders for execution at the fixing should therefore be received before these times.

8. No dealings take place before fixing; orders received after the fixing are executed at, or as near as possible to, the official prices

9. The normal basis on which prices are fixed is that all effective offerings for sale must be absorbed, so that selling orders received in time are executed at the fixed prices. It may happen on occasions that offerings at the fixed prices are insufficient to satisfy buyers, whereas higher prices would have produced a preponderance of selling, thus making it impracticable to fix at the higher level, or there may be an excess of buying over selling orders at the fixed prices, in such circumstances the Broker may not always be able to execute buying orders in full at the fixed prices.

10. If buyers send orders for silver which is required before the expiration of seven days, they may, if there is a scarcity of ready silver, be unsuccessful in securing it, except at a premium over the official spot quotation.

CONTRACTS

11. The term "contract" does not imply any particular quantity

BROKERAGE.

12. The brokerage charged on all silver purchases made at a price exceeding 21d. per standard ounce is one-eighth per cent, the brokerage charged on all silver purchases made at a price not exceeding 21d. per standard ounce is at the rate of £1 2s. 0d. per 10,000 standard ounces. In either circumstance the minimum brokerage is £1.

13. Sales are effected free of brokerage.

14. No deviation from the above-mentioned rate of brokerage will be made, whether in the form of rebate to purchasers or allowance to sellers, or in any other way.

DELIVERY.

15. All contracts are for delivery at the office of the Broker; any charges incurred for collection, shipment, cartage, warehousing, etc., will be payable by the client

16 Deliveries of silver bars in fulfilment of contracts must be made in commercial bars assaying 966/1000, 997/1000, 998/1000, or 999/1000 which is the highest quality recognized; fractions of milliemes are ignored. Silver of qualities lower than 966/1000 is subject to charges incurred for refining up to the required level.

17. Commercial silver bars vary in weight but those weighing from about 900 to about 1,250 ounces troy are acceptable

18. As a seller is entitled to deliver bars of any of the qualities recognized as good delivery, the Broker is naturally unable to guarantee to make delivery in bars of a particular quality; the Broker will, however, do his best to meet the wishes of the client in this respect.

EXTENSION OF CONTRACTS.

19. If near the date of maturity of a contract it is desired to prolong it for a further period instead of making or taking delivery, the prolongation can normally be effected by the re-sale (or re-purchase) of spot and the purchase (or sale) of forward on the same terms as those governing ordinary purchases or sales.

When, however, there is a premium on spot, a client who wishes to prolong a sale contract should, in his own interests, give instructions at least seven days before maturity, as otherwise he runs the risk of having to pay an extra premium to obtain silver for delivery in less than the seven days mentioned in Rule 10.

Instructions regarding the liquidation of a contract falling due, should in any case be received at the latest in time for fixing on the day prior to the due date, in the absence of which the Broker reserves the right to extend the contract for a period of two months on the best terms obtainable.

MARGIN.

20. A margin of 15 per cent is required on all forward contracts; failure to deposit margin entitles the Broker to close the contract at his discretion by a re-sale or repurchase.

21. Margin will not be released by the Broker while a

contract remains open, even though fluctuations in prices may show a profit in favour of the client.

22. Differences on closed contracts are only payable on the due date; prior to this, however, any such difference in a client's favour may be considered as margin on fresh operations provided that all outstanding contracts are covered by a margin of 15 per cent.

23. In the event of any margin becoming reduced to below 12 per cent, further cover must be provided to restore the margin to 15 per cent. Failure to provide the further cover within forty-eight hours after notice requiring it (exclusive of Sundays and English Bank Holidays) entitles the Broker to close the contract as in Rule 20. In the event of there being no forward quotation fixed at any time, margin will be calculated on the basis of the cash quotation.

24. Margin may be provided in cash or in approved securities; interest on cash deposited as margin will be allowed by the Broker at 1 per cent under Bank of England Rate

STORAGE OF SILVER.

25 Storage of silver can be arranged on the following terms—

(a) Actual bars can be allocated and a weight list rendered, in which case the storage charge is 9d. per bar per month (proportionately for broken periods); this charge does not include insurance, but, if desired, cover would be effected by the Broker at current rates for the client's account

(b) The silver can be held by the Broker without allocating any special bars, in this case storage is charged at the rate of 7d. per bar per month (proportionately for broken periods) on the basis of 80 bars equalling 100,000 standard ounces. Insurance on unallocated silver is covered by the Broker in bulk, and the cost of such insurance is included in the storage charge.

(c) If warehouse warrants are asked for, this can be arranged, the client being debited with the cost of cartage to the warehouse and the charge for the warrants.

POWER TO SUSPEND.

26. The London Brokers reserve to themselves the right to suspend or vary these conditions, or any of them, with

or without notice, if in their opinion they consider that circumstances have rendered such a course desirable.

The following additional conditions have special reference to orders received from India.

PAYMENT.

27. When silver is required for shipment, payment is to be made on the Monday of the week during which shipment is to be effected. In the event of the order for shipment being executed on or after the first day of the week of shipment, payment is to be made on the working day following the execution of the order. Silver purchased on the actual date of delivery to the Shipping Company is value the same day.

28. When silver has been purchased for any forward date other than for the recognized delivery of two months from the date of the contract, and is required for shipment, payment is likewise to be made on the Monday of the week during which shipment is to be effected.

29. Interest on all payments received later than the due dates, as indicated in Rules 27 and 28, will be charged at 1 per cent over Bank of England Rate.

SHIPMENT.

30. Normally the special train to catch the P. & O. Mail Steamer to India leaves London at 9 a.m. on Fridays. Consequently silver bought for delivery later in the week than Thursday is too late to ensure shipment that week.

It would be a convenience to the Broker if clients sent their shipping instructions as early in the week as possible.

MARGIN.

31. Rules 20 to 23 above are applicable to all Indian orders for delivery later than the week following the date of execution.

32. Margin may be provided in either of the following ways—

(a) By cash in London (interest thereon to be credited by the Broker to his client at 1 per cent per annum below Bank of England Rate).

(b) By the deposit of cash, or British or Indian Government Securities to Bearer in India with an approved bank having an office in London, the cash or securities being held at the disposal of the Broker while the interest allowed by the bank or accrued interest on the securities is to be

credited by the Broker to his client through the bank. Any charge made by the bank for keeping the securities to be defrayed by the client. The Broker to have the power to realize the securities, or to transfer into sterling deposits made in rupees.

33. In the case of margin deposited under system (*b*) this will not be considered as a deposit until the Broker has received from the bank telegraphic advice through its London office to the effect that the amount of margin is held by the bank at the disposal of the Broker; the deposit will be at the depositor's risk.

CABLES.

34. All cables will be at the client's expense, with the exception of those advising the execution of orders of £25,000 or over, which will be at the Broker's expense.

CHAPTER XIV

THE GREAT WAR AND THE LONDON MONEY MARKET

THIS work would be incomplete without a reference to the manner in which the London Money Market met the crisis brought upon it at the opening of the Great War

One of the first signs of the imminence of a war between nations having intimate commercial relations is the speed with which merchants and financiers of the respective countries begin to realize their opposing claims. Every one seems to be obsessed with the desire to hold hard cash. There is an eagerness to collect foreign debts and to dispose of all tangible securities in exchange for gold; and the more strained the tension becomes, the more pronounced will be the desire to convert foreign balances into cash, no matter how great the sacrifice. This liquidation of claims will grow in intensity until diplomatic relations are broken off; it will not even cease at that point, for immediately war is declared and hostilities commence, the claims of the belligerent nations will be dumped upon neutral markets for realization, until all are surfeited with the many and varied forms which foreign indebtedness takes. At this stage the neutral nations also become involved in the financial strain which, at first, merely affects the countries which are at war. It is then that people begin to realize that the money markets of the world, of which London is the centre, comprise one great machine; consequently, any dislocation in one part must inevitably react on all other portions of the machinery.

Market Conditions in 1913-14.

The great European conflict, as it happened, came at an awkward moment for all the principal financial centres. The London market was disturbed by the Irish Home Rule question; France and other Continental nations were only just recovering from the effects of the Balkan

War. Throughout 1913 this depression was very evident, and the financial condition of the markets of the world was unsatisfactory. Most Continental centres were overloaded with securities, and a great many more issues had been floated on the London market than the British investors were able comfortably to absorb. During the early part of 1914, however, a turn for the better took place: gold flowed into Paris from New York as the result of the French realization of securities on the American market (those behind the scenes were apparently preparing for eventualities). The Bank of England, for its part, was able to procure a sufficiency of the precious metal. Money rates dropped in consequence, and ease prevailed on most centres for a time. To any one who probed beneath the surface, however, it was apparent that an undercurrent of doubt existed, and uneasiness began openly to manifest itself towards the end of May, 1914.

The reserve of the Bank of England fell to a lower level than was liked, and at the same time a great demand for gold sprang up from the Continent. French exchange was against London during the whole of the month, but that of Germany was in favour of London. Yet, out of the gold arrivals in London during the five months in question, amounting to nearly £26,000,000, the Bank of England secured rather less than £7,000,000. French and German agents took the rest, and the amount of gold that was sent to those countries in May, 1914, alone was about equal to the whole of the exports for the year 1913 (£46,000,000). It was reported that Russia was to be the ultimate destination of a portion of these continental purchases, but subsequent information proved that the greater part of the metal found its resting place in the vaults of the central banks of France and Germany.

"Panicky" Markets.

Early in 1914 the American exchange turned in favour of London; there was an excess of imports into America,

payment for which was met mainly in gold. The adverse exchange was partly due to the failure of the harvest in the United States, and partly to the fact that speculation was then at a very low ebb in New York. In the circumstances, the call for gold for Europe was soon evident in the United States, and during the first half of 1914 the shipments for the Continent were greater than in any one of the preceding three years. Despite the almost unprecedented ingathering of gold by Continental nations, there does not appear to have been any great perturbation until the turn of the half-year. Then the Austro-Serbian imbroglio began to take definite shape, and the influence of the strained relations between the two countries was immediately seen on the London market by the hardening of discount rates. On July 18, 1914, the news leaked out that the London branch of the Dresdner Bank was selling its securities and advising its clients to act similarly. This was considered to be the first semi-official intimation of a probable European conflict. Continental markets became "panicky," and by July 20, the conditions on the Berlin Bourse were excitable in the extreme. French and Austrian bourses were also unsettled and the prices of securities were falling rapidly. By July 25, fears of war became more pronounced; money was everywhere in demand; increased margins on loans against securities were required by the banks, and both England and France were reported to be withdrawing capital from Germany as quickly as possible. Those who held bills and other short-term securities turned them into cash at considerable sacrifices, and had the money transferred to London and Paris. Berlin, for its part, was straining every endeavour to realize its Russian credit balances. The enormous selling of securities brought some of the bourses to a full stop; and on July 26, those in Vienna, Amsterdam, and Brussels were all obliged to close, while in Paris only a limited amount of business was possible.

Paris, it was evident, was caught between Scylla and Charybdis; she was embarrassed by her holdings of short-dated securities as the outcome of operations financed for Turkey and the Balkan States, and before she could rid herself of this incubus she was caught in the whirlpool of the monetary crisis which had spread over the whole of Europe. Gold disappeared as if by magic, and heavy calls were made on all the banks in France for hard cash. In an attempt to stem the tide, on July 31, the Bank of France raised its rate from 3½ per cent to 4½ per cent, and its rate of interest on advances from 4½ per cent to 5½ per cent.

The German Rush for Gold.

Berlin went through a similar experience. Everywhere there was a great pressure for gold; the banks were literally besieged, and there was a great run on the Imperial Bank of Germany, which, it is reported, parted with no less than 200,000,000 marks in gold in its endeavour to allay the alarm. So great was the pressure that in a short while the German Government passed a measure prohibiting the Bank from paying any more of its notes in gold. On July 31 the Imperial Bank was obliged to raise its rate of discount from 4 per cent to 5 per cent and its rate of interest on advances from 5 per cent to 6 per cent.

Closing the Exchanges.

On the Berlin Bourse, by order of the President, from July 31 no prices were fixed; and although it was announced that "transactions were confined to a cash basis," there was really no business at all in securities. The Hamburg Stock Exchange was closed on July 30.

Attention was then turned to London and New York, and in London there was an enormous rush to sell securities on Continental account. Of London we shall speak presently. New York, finding itself besieged with selling

orders, became suddenly panic-stricken, and the Committee of the Stock Exchange there was forced on July 30 to announce that the Exchange would be closed until further notice.

The Crisis of 1914.

London, as the monetary centre of the world, early became involved in the great financial cataclysm. About July 20, 1914, it was somewhat difficult to deal on the Stock Exchange, and jobbers were refusing to give quotations unless the broker would state definitely whether he was a buyer or seller, and for what amounts. The premier stock, Consols, commenced to fall heavily, and other stocks and shares followed suit. The London banks became cautious; the financial houses were still more so, and it was passing difficult to renew loans. Discount rates, which on July 24 had been as low as 2⅝ per cent for three months bills, on July 28 moved up to 4 per cent; and the next day the rates quoted were: for Bank bills at three, four, and six months' date, anything from 4¾ per cent to 5 per cent; while fine trade bills were quoted at 5 per cent 5½ per cent, and 5½ per cent for similar usances, and no buyers were anxious to take them. All the rates, however, were purely nominal and, owing to its being almost impossible to place bills, the market was temporarily paralyzed for want of funds.

The rates of exchange on both the French and German centres were such as to make it profitable to export gold to London; but no gold came, for the continental banks were well able to protect their gold stocks and, instead of receiving the metal, London had herself to send large shipments to France.

Dealers on the open market were soon at the end of their resources, *despite their sacrifices of securities on the Stock* Exchange. The banks were inundated with requests for funds from all directions, and they were forced to call in their loans. As a result, the bill brokers and others were

obliged to seek accommodation by borrowing from the Bank of England. The Bank assisted them by purchasing their "short" bills. This was on July 29. By July 30 the pressure of sales on the London Stock Exchange became almost unbearable. Enormous quantities of stocks were disposed of on foreign account at any prices that could be obtained, and, finally, the "House" itself was seen in the toils. It was no longer able to absorb the large quantities of stocks and shares which had been forced on the market from all quarters. Three or four firms of stockbrokers were unable to meet their liabilities and were "hammered." Had the business been allowed to continue, there is little doubt that many more reputable brokers would have met the same fate. As it was, the banks and brokers pressed the Stock Exchange Committee to take action, and on Friday morning, July 31, just before the time for opening, it was announced that the Stock Exchange would be closed until further notice.

Protecting the Central Gold Reserve.

In the meantime, the pressure on the Bank of England had not abated. On July 30 it became necessary to take precautionary measures to protect the gold reserve by raising the official rate from 3 per cent to 4 per cent. The joint stock banks themselves were experiencing something in the nature of a "run," and every available loan had to be called from the market, with the result that practically the whole market was "in the bank." As we have said, the Bank of England helped the brokers at first by discounting their short bills; the charge was 6 per cent.

This high rate, charged on July 30, was no deterrent. As the day went on the pressure increased, and in proportion to the borrowings the Bank was obliged to raise its rates until 10 per cent was charged for discounting bills with only about fifteen days to run. On loans for a week the rate was still higher, as much as 10½ per cent being charged

and paid. The pace was too hot for any bank in the world to follow; the "rot" had set in and to check it drastic measures were necessary. Therefore, the Bank took the unusual step of altering its Rate on a Friday, it was advanced, on July 31, 1914, to 8 per cent, the highest figure reached since the year 1873; and on the next day, August 1, it became necessary to raise the Rate again to 10 per cent.

London borrowings were not the only cause of this action; it was partly due to heavy withdrawals of gold from the Bank for foreign account, to which we have referred earlier. On one day, July 31, 1914, no less than £1,204,000 was taken for shipment to the Continent. It is possible that, had not insurance rates been prohibitive, attempts might have been made to get even more gold out of the country. Even for ordinary cargoes the rates were high; they started at about ¼ per cent, and within a week the premium had risen to 21 per cent, with no insurance brokers anxious to write risks at the rate. As a matter of fact, the gold drawn from England during the week ended August 1, 1914, was £2,514,000 against £824,000 received, making a net efflux for the week of £1,690,000.

Bank Rate Movements.

As showing the movements in Bank Rate in 1914, it may be said that the Rate stood at 3 per cent from January 29 to July 29, it was raised to 4 per cent on July 30, to 8 per cent on July 31, and to 10 per cent on August 1. The 10 per cent rate lasted until August 6, when it was reduced to 6 per cent. Two days later it was again reduced to 5 per cent, at which level it remained until July 13, 1916.

The movements in Bank Rate during 1914 have been termed "panic" rates, but that they are not unexampled in the history of the Bank of England may be seen from the table shown on page 230 of previous high rates.

Period.	Rate.	Period.	Rate.
Oct. 25th, 1847	8%	Aug. 4th, 1864	8%
„ 19th, 1857	8%	Sept 8th, „	9%
Nov. 5th, „	9%	Nov. 10th, „	8%
„ 9th, „	10%	Jan 4th, 1866	8%
Dec 24th, „	8%	May 8th, „	8%
Feb. 14th, 1861	8%	„ 11th, „	9%
Dec 3rd, 1863	8%	„ 12th, „	10%
Jan 20th, 1864	8%	Aug 16th, „	8%
May 2nd, „	8%	Nov 1st, 1873	8%
„ 5th, „	9%	„ 7th, „	9%
„ 19th, „	8%	„ 20th, „	8%

Let us continue with the record of the dark days of August, 1914. Sunday, August 2, gave the market a breathing space, though the officials of most banks and finance houses were at their posts, and the next day, being a bank holiday, people were given a chance to steady their nerves. Then, in order to give the Government time to prepare emergency currency, and financiers and banks an opportunity to take stock of the position and marshal their resources, it was decided to declare the days from August 4 to 6 additional bank holidays Not taking into account these days, we may, therefore, say that the actual crisis lasted only four days

How Bankers Faced the Crisis.

It is easy to be wise after the event, and to say that the banks might have met the situation differently and more courageously; but the circumstances were exceptional—how exceptional it will probably never be realized Most bankers did face the position bravely and paid out all the gold they could. Others, well, were not so calm, and paid out only a portion of the money demanded in gold and the rest in Bank of England notes. The effect of this was merely to drive the panic-stricken public to the Bank of England to present the notes for gold. The attitude of some of the bankers thus might have been questionable; but that of some sections of the public was still more so. The writer recalls an incident which occurred on July 31—it is one of many. A person drove up to one of the banks in a motor car, entered and presented her cheque

for £700, which she took in gold and carried away with her. With such things happening, there is little wonder that bankers began to "draw in their horns." The banks were adversely criticized for calling in their loans from the discount market, since this action to some extent aggravated the trouble and enhanced the demand on the Bank of England for accommodation. But, in face of the demand from the public, only those institutions which were prepared with large reserves could cope with the situation.

The London banks, however, were not alone in their ultra-cautious policy. Practically the whole Continent—from Paris to St. Petersburg, from Amsterdam to Berlin, and from Vienna to Rome—was seeking to convert paper promises to pay into cash, added to which the great banks in Paris and Berlin were hoarding gold against emergencies, and were even adding to their supplies.

Suspension of the Bank Act.

Fortunately, the prompt measures taken by the British Government, in consultation with the Bank of England authorities, were effectual in staying the timidity with which a large section of the community had began to view the abnormal situation. That even stronger measures would have been taken had circumstances called for them is evident by the frank way in which the Press was allowed to announce, on August 1, 1914, that proposals were under consideration for obtaining the Government's assent to the suspension of the Bank Charter Act of 1844, the effect of which would have been to enable the Bank of England, if necessary, to issue notes without holding gold against them. To paraphrase the leading article of *The Times* of August 1, 1914, in the opinion of the Government that course was not then actually necessary, but the Chancellor of the Exchequer was understood to be ready to give the Bank authority to act, merely by the issue of an official letter from the Treasury; and the announcement that, should the situation require, he *would* issue the

necessary letter, no doubt went far to restore the confidence of the City and all connected with it.

That the necessary authority was actually given is evident from the following letters which passed between the Bank of England and the Chancellor of the Exchequer on August 1, 1914, they are important as giving an accurate account of what took place—

(I) Letter from the Bank of England to the Chancellor of the Exchequer, dated August 1, 1914—

August 1, 1914.

SIR,—

We consider it to be our duty to lay before the Government the facts relating to the extraordinary demands for assistance which have been made upon the Bank of England in consequence of the threatened outbreak of hostilities between two or more of the Great Powers of Europe.

We have advanced to the Bankers, Bill Brokers, and Merchants in London during the last five days upwards of Twenty-seven Millions Sterling, upon the security of Government Stock, Bills of Exchange, etc., an unprecedented sum to lend, and which, therefore, we suppose, would be sufficient to meet all their requirements; although the proportion of this sum which may have been sent to the country must materially affect the question.

We have not up to the present refused any legitimate application for assistance, but having regard to the depletion of the reserve, we fear that unless we obtain authority to issue Notes against Securities in excess of the amount permitted by law it will shortly become necessary to curtail the facilities which under present conditions we regard it as essential to offer to the trade and commerce of the country.

We have the honour to be, Sir,

Your obedient Servants,

(Signed) WALTER CUNLIFFE.

(Signed) R. L. NEWMAN.

The Right Honourable

The Chancellor of the Exchequer

(II) *Letter from the Prime Minister and Chancellor of the Exchequer to the Bank of England, dated August 1, 1914*—

Treasury Chambers,
Whitehall, S.W.,
August 1, 1914.

GENTLEMEN,—

We have the honour to acknowledge the receipt of your letter of this day to the Chancellor of the Exchequer in regard to the extraordinary demands which are being made upon the Bank of England in consequence of the threatened outbreak of hostilities between two or more of the Great Powers of Europe.

In the circumstances represented, His Majesty's Government recommend that, if the Bank of England shall find that, in order to meet the wants of legitimate commerce, it is requisite to extend its discounts and advances upon approved securities so as to require issues of Notes beyond the limit fixed by law, this necessity should be met immediately upon its occurrence, and in that event they will not fail to make application to Parliament for its sanction.

No such discount or advance should be granted at a rate of interest less than 10 per cent, and His Majesty's Government reserve it to themselves to recommend, if they should see fit, the imposition of a higher rate.

After deduction, by the Bank, of whatever it may consider to be a fair charge for its risk, expense, and trouble, the profits of these advances will accrue to the public

We have the honour to be, Gentlemen,
Your obedient Servants,
(Signed) H. H. ASQUITH.
(Signed) D. LLOYD GEORGE

To the Governor and Deputy-Governor,
Bank of England.

It should be noted that "for a very short time the Bank of England did exceed the issue limit of uncovered notes fixed by the Bank Charter Act of 1844," and this, in effect, amounted to a suspension of the Act.[1]

[1] *Cf. British Finance*, 1914–1921 (pp. 6–7), edited by A W Kirkaldy.

Revelation of Bank Returns.

In the three successive Returns of the Bank of England for the weeks ending **July 22 and 29**, and August 7, 1914 the progress of the **monetary crisis** is clearly discernible. We give the Returns in full—

COPY]

BANK OF ENGLAND

ACCOUNTS pursuant to the Act 7 and 8 VICT. cap 32, for the week ended on Wednesday, the 22nd day of July, 1914.

ISSUE DEPARTMENT

	£		£
Notes Issued . .	57,014,410	Government Debt	11,015,100
		Other Securities .	7,434,900
		Gold Coin and Bullion	38,564,410
		Silver Bullion . .	—
	£57,014,410		£57,014,410

Dated 23rd day of July, 1914

J G NAIRNE,
Chief Cashier.

BANKING DEPARTMENT

	£		£
Proprietors' Capital	14,553,000	Government Securities . . .	11,005,126
Rest	3,446,453	Other Securities .	33,632,762
Public Deposits—(including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts)	13,735,393	Notes . . .	27,697,120
		Gold and Silver Coin	1,599,931
Other Deposits .	42,185,297		
7-Day and Other Bills	14,796		
	£73,934,939		£73,934,939

Dated the 23rd day of July, 1914

J. G NAIRNE,
Chief Cashier.

COPY.]

BANK OF ENGLAND

ACCOUNTS pursuant to the Act 7 and 8 VICT. cap 32, for the week ended on Wednesday, the 29th day of July, 1914

ISSUE DEPARTMENT

	£		£
Notes Issued	55,121,405	Government Debt	11,015,100
		Other Securities	7,434 900
		Gold Coin and Bullion	36,671,405
		Silver Bullion	—
	£55,121,405		£55,121,405

Dated 30th day of July, 1914

J G NAIRNE,
Chief Cashier

BANKING DEPARTMENT

	£		£
Proprietors' Capital	14,553,000	Government Securities	11 005,126
Rest	3,491,756	Other Securities	47,307,530
Public Deposits—(including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts)	12,713,217	Notes	25,415,055
Other Deposits	54,418,908	Gold and Silver Coin	1 460,139
7-Day and Other Bills	10,969		
	£85,187,850		£85,187,850

Dated the 30th day of July, 1914.

J. G. NAIRNE,
Chief Cashier

COPY.]

BANK OF ENGLAND

AN ACCOUNT pursuant to the Act 7 and 8 VICT. cap. 32, for the week ended on Friday, the 7th day of August, 1914.

ISSUE DEPARTMENT

	£		£
Notes Issued . .	44,491 070	Government Debt	11,015,100
		Other Securities .	7,434,900
		Gold Coin and Bullion	26,041,070
		Silver Bullion .	—
	£44 491,070		£44,491,070

Dated the 7th day of August, 1914.

J G. NAIRNE,
Chief Cashier.

BANKING DEPARTMENT

	£		£
Proprietors' Capital	14,553,000	Government Securities . . .	11,041,152
Rest	3,547,083	Other Securities .	65,351,656
Public Deposits— (including Exchequer Savings Banks Commissioners of National Debt and Dividend Accounts)	11,499,452	Notes	8,385,650
		Gold and Silver Coin	1,580,999
Other Deposits	56 749,610		
7 Day and Other Bills . . .	10,312		
	£86,359,457		£86,359,457

Dated the 7th day of August, 1914.

J. G. NAIRNE,
Chief Cashier.

The reader who has studied carefully Chapter III will have no difficulty in analysing the position. From a glance at these returns he will see that the London bankers had evidently taken immediate steps to strengthen their cash position, for "Other Deposits" between July 22 and August 7, 1914, revealed an increase of £14,564,313. Then the bill brokers, who had been called upon to repay their loans to the bankers, were obliged to resort

to the Bank of England for assistance in order to repay these loans, and the nature of that assistance is traceable in an increase in "Other Securities" of £31,718,894. The total amount of "Gold Coin and Bullion" in the Bank was also reduced in the same period from £40,164,341 to £27,622,069; of the amount withdrawn—£12,542,172—about £3,000,000 was taken for the Continent, the remaining £9,542,000 being absorbed by London and the Provinces.

There was also a diminution in the Reserve to £9,966,649, the ratio to liabilities falling from 52·375 per cent to 14·6 per cent.

The measures which the Government also took to meet the public need for currency are now matters of common knowledge, but we may refer briefly to them.

Under the Currency and Bank Notes Act of August 6, 1914, the use of postal orders as legal tender was permitted for a short period, and the Treasury was authorized to issue currency notes for £1 and 10s These were legal tender to any amount, but the postal orders ceased to be so after February 3, 1915. Under Clause 3 of the Currency and Bank Notes Act of 1914, it was provided that the Bank of England and any Scottish or Irish banks of issue "might issue notes in excess of the limit fixed by law so far as temporarily authorized by the Treasury, and subject to any conditions attached to that authority. Banks of issue were indemnified against any liability on the ground of excess of issue after August 1, 1914, in pursuance of any authority from the Treasury."[1]

Issue of Currency Notes.

The assistance to bankers under the Currency and Bank Notes Act was valuable. It provided for currency notes to be issued through the Bank of England, as and when required, up to a maximum limit not exceeding, in the

[1] *Cf. British Finance*, 1914–1921 pp. (6–7), edited by A. W Kirkaldy.

case of any bank, 20 per cent of its liabilities on deposit and current accounts. The amount of notes issued to each bank was treated as an advance by the Treasury to that bank bearing interest from day to day at the current Bank Rate, the security for the Treasury advances consisting of a floating charge on the assets of the bank up to the amount of the notes issued. Permission was given to the banks to repay the whole or any part of an advance at any time. It was further provided that any amount repaid could be renewed if and when necessity arose, provided that the total amount outstanding at any one time did not exceed the authorized percentage of the bank's liabilities.

Subsequently, in order to enable the banks to take advantage of the credit allowed under this arrangement, even though the actual currency might not be required, an Amendment Act was passed on August 28, 1914, giving the Treasury power to issue certificates in lieu of actual notes [1] The effect of the issue of these certificates was to enable the banks to obtain credits with the Bank of England on the same terms as currency for notes.

In the early stages of the War the banks availed themselves of this concession to the extent of about £13,000,000, but the amount was reduced at the earliest possible moment, apparently by means of transfers through the Bank of England, and by September 30, 1914, the advances outstanding had fallen to £381,500, and little, if any, advantage was taken of the concession afterwards. In Clause 8 of the Report of the Committee on Currency and Foreign Exchanges after the War, dated December 3, 1919, it was recommended that the Treasury Minute, made under Section 2 of the Currency and Bank Notes Act, 1914, providing for the issue of currency notes to the joint stock banks, should be withdrawn. At the date of their Report, it was, in fact, inoperative; and on

[1] The Currency and Bank Notes (Amendment) Act, 1914 (4 & 5 Geo V, c 72).

December 15, 1919, the Treasury, acting on the recommendations of the Currency Committee, announced the withdrawal of the concession.

In Clause 7 of their Final Report, the Committee also intimated that the time had come to withdraw the legal tender status given to the Scottish and Irish bank notes under the Currency and Bank Notes Act of 1914 as an emergency measure. Accordingly, on December 15, 1919, the Treasury announced that the notes of these banks would revert to their pre-War status.

Currency Notes Certificates.

The Currency Notes Certificates, issued under Section 2 of the Currency and Bank Notes (Amendment) Act, 1914, were certificates entitling the holder to demand from the Bank of England, acting for the Treasury, the amount of notes mentioned in the certificate When the banks wished to increase their own reserve of cash they would take from the Bank of England currency notes or currency notes certificates at their option If they took the latter, they were able later to exchange the certificates for currency notes. When banks withdrew currency notes or currency notes certificates from the Bank of England their balances thereat were debited for the amount, and the cash balances of the Currency Notes Redemption Account, kept at the Bank of England, were credited with the same amount.

The aggregate amount of Currency Notes and Currency Notes Certificates outstanding on November 22, 1928, was £285,504,130 10s., of which Currency Notes Certificates represented £18,880,000

Recalling Foreign Balances.

Emergency measures in connection with the provision of currency were not the only ones the Government had to take in 1914; immediate assistance had also to be given to the London Money Market. As we have stated

earlier, on the first signs of war, London bankers made use of their first line of defence, and called in their short loans to bill brokers; then both the banks and the financial houses proceeded to call in their balances from abroad, and those in the foreign centres who were under the obligation to remit had purchased all the available bills on London. Shipments of commodities were for the time being held up, and no more bills therefore were forthcoming, while it was practically impossible to ship gold. Foreign exchange facilities for some days were non-existent. As a last resort, foreign countries might have made sterling available by selling securities, but with the closing of the Stock Exchange that possibility was at an end, and on July 31 foreign telegrams reported that bills on London were unobtainable. London, by promptly recalling its foreign balances, had tightened the screw so effectually that the machinery of the foreign exchanges, based upon sterling, itself broke down, and remittances which London accepting houses and others expected from abroad were not forthcoming. In the circumstances, the accepting houses were in a precarious position; they were between "the devil and the deep sea," for, on the one hand, they were unable to get remittances from abroad, and, on the other, the London bankers had called in loans and were not advancing further funds. Their anxieties were increased by bills being presented for payment by holders who were unable or unwilling to renew them for the acceptors, and it looked as if the War for the time being had torn through the delicate fabric of credit out of which the London Money Market had profited so long and so marvellously. The only course left, then, was for the Government to come to their aid and declare a Moratorium, the necessary Proclamation for which was issued on Sunday, August 2, 1914.

The nature of the assistance which the British Treasury made available to banks and discount houses, and other details connected therewith, will be found in the official

Government Paper in the Appendices, but it will be of interest to comment briefly on the matter

The Moratorium.

The Official Notice proclaiming the Bill Moratorium on August 2, 1914, gave power to acceptors of bills to re-accept them for a period of one month from date of maturity, and provided for interest to be added to the original amount of the bill, calculated from the date of re-acceptance to the new date of payment at Bank of England rate current on the re-acceptance date A second Proclamation was issued on August 3, 1914, called the Postponement of Payments Act, which gave general powers to suspend temporarily the payment of bills of exchange and payments in pursuance of other obligations, and this was followed on August 6, 1914, by a General Moratorium, which gave the banks and other debtors, with few exceptions, power to suspend payment for one month of debts payable before the date of the Proclamation. This General Moratorium was subsequently extended by Proclamation from time to time, and finally came to an end on November 4, 1914; but the London Stock Exchange did not re-open until January 4, 1915.

The next step to be undertaken was the rehabilitation of the London bill market, for without international currency, in the shape of bills of exchange, business was at a standstill. Long and earnest conferences took place between the Chancellor of the Exchequer, the Bank of England, the principal bankers, discount houses, and traders of the country with a view to deciding the best means of providing the country with banking facilities needed in the emergency.

It was recognized that the main difficulty arose from the stoppage of remittances to London, both from the provinces and from other countries, not only in Europe, but in all parts of the world This, as we have pointed out, caused an entire dislocation of the foreign exchanges,

and deterred bankers from discounting bills in the normal way. The real difficulty with which the banks, and more particularly the London discount houses, were faced, was the possession of bills of exchange which the accepting houses in London were unable to meet because the drawers of the bills had not been able to remit to London the necessary funds.

Government Guarantee Against Loss.

Ultimately, to overcome this difficulty, as well as that of providing traders in the country with the necessary banking facilities, the Government agreed to guarantee the Bank of England from any losses it might incur in discounting bills of exchange, either home or foreign, bank or trade, accepted prior to August 4, 1914. They accordingly authorized the following announcement to be made on August 13, 1914—

"The Bank of England are prepared, on the application of the holder of any approved bill of exchange accepted before the 4th day of August, 1914, to discount at any time before its due date at Bank Rate without recourse to such holder, and upon its maturity the Bank of England will in order to assist the resumption of normal business operations give the acceptor the opportunity until further notice of postponing payment, interest being payable in the meantime at 2 per cent over Bank Rate varying. Arrangements will be made to carry this scheme into effect so as to preserve all existing obligations.

"The Bank of England will be prepared for this purpose to approve such bills of exchange as are customarily discounted by them and also good trade bills and the acceptances of such foreign and colonial firms and bank agencies as are established in Great Britain."

Restoration of Confidence.

This measure was very effective in restoring the confidence in British credit abroad; the home market took

heart, and bankers and brokers set to work with a will to put the wheels of the London Money Market machinery revolving once more. Large wads of bills were immediately sent forward to the Bank of England for discount, and after the first few days the business proceeded smoothly. Difficulties, however, were encountered in regard to new bills. The accepting houses and banks were not keen to do business unless evidence was forthcoming that the bills were drawn against goods consigned to the United Kingdom, the reason being that, so long as the exchanges were not working freely, the danger of non-receipt of foreign remittances at date of maturity was still existent. The joint stock banks, too, were for a time somewhat averse from purchasing the new acceptances the brokers were receiving from the foreign and colonial banks against imports. In the meantime, the dislocation of exchange was exercising an extremely prejudicial influence upon trade and commerce, especially upon the foreign trade of the country. In the absence of the usual exchange facilities, goods could be neither imported nor exported in any appreciable quantity. To ascertain the causes, and to find a remedy for the difficulties, the Chancellor of the Exchequer again consulted a large number of leading traders, members of accepting houses, and bankers Ultimately, after a series of conferences at the Treasury, an announcement was made in the Press by the Chancellor of the Exchequer that an arrangement had been arrived at which was designed to remove the difficulties.

The principal features of the scheme may be summarized as follows—

1. The Bank of England will provide acceptors where required with the funds necessary to pay all approved pre-moratorium bills at maturity. This course will release the drawers and indorsers of such bills from their liabilities as parties to these bills, but their liability under any agreement with the acceptors for payment or cover will be retained.

2. The acceptors will be under obligation to collect from

their clients all the funds due to them as soon as possible, and to apply those funds to repayment of the advances made by the Bank of England. Interest will be charged upon these advances at 2 per cent above the ruling Bank Rate.

3. The Bank of England undertakes not to claim repayment of any amounts not recovered by the acceptors from their clients for a period of one year after the close of the war. Until the end of this period the Bank of England's claim will rank after claims in respect of post-moratorium transactions.

4. In order to facilitate fresh business and the movement of produce and merchandise from and to all parts of the world, the joint stock banks have arranged, with the co-operation, if necessary, of the Bank of England and the Government to advance to clients the amounts necessary to pay their acceptances at maturity where the funds have not been provided in due time by the clients of the acceptors. The acceptor would have to satisfy the joint stock banks or the Bank of England both as to the nature of the transaction and as to the reason why the money is not forthcoming from the client. These advances would be on the same terms as regards interest as the pre-moratorium bill advances.[1]

These arrangements were successful in completing the restoration of confidence in the London Money Market, of resuscitating the business in international exchange, and of freeing the wheels of the machinery from the mass of accumulated claims that had been for a brief period clogging its working

From this time forward the London Money Market was able to steer its own barque; and though the waters through which it passed until the end of the War were at times most troublesome, and progress was difficult in the face of much prohibitory legislation, yet the record of the war years goes to prove that London had once more vindicated its pre-eminent position as the monetary centre of the world

[1] *Cf* *Manual of Emergency Legislation* (pp. 35–6), Financial Edition (June, 1915)

As a further record of the stability of the London Money Market and the inherent honesty of those responsible for its working, we may add that the Bank of England advanced something like £120,000,000 by the purchase of these bills. By September, 1922, the bulk of the bills had been redeemed, it being estimated that barely £5,000,000 remained in "cold storage," and before the end of 1923 there is no doubt that most of the outstandings were liquidated.

So ends our survey of the London Money Market. Much more might have been written concerning it, but sufficient has been said, we imagine, to show what a wonderful piece of machinery is that of the London Money Market. A study of what goes on in the money market day by day is a study of men and affairs; and we conclude, as we began, by urging those who have the welfare of the country and Empire at heart—and who has not?—to endeavour to learn as much as possible about the money market and the operations conducted therein. The more the men of to-day know of the operations that take place in the London Money Market, the greater will be their pride in it, and the greater their ability in upholding its supremacy. The problems that may arise in the future will be, as they have been in the past, many and diverse, and the solution of them varying and difficult. But, if the reader is able, by reason of his being forearmed with a knowledge of the internal mechanism of the money market, to assist in the elucidation of any one of those problems, he will feel amply repaid for the hours he has spent in acquiring that knowledge. For knowledge itself is power.

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APPENDICES

APPENDIX I

PAPERS relating to the assistance rendered by the TREASURY to BANKS and DISCOUNT HOUSES since the outbreak of War on the 4th August, 1914, and to the questions of the advisability of continuing or ending the MORATORIUM and of the nature of the banking facilities now available

I.—ISSUE OF CURRENCY NOTES TO BANKS

The following are the arrangements made in accordance with the provisions of the Currency and Bank Notes Act, 1914, for placing currency notes at the disposal of the Banks for meeting exceptional demands

(1) *England and Wales*

Currency notes are issued through the Bank of England to bankers as and when required up to a maximum limit not exceeding, in the case of any bank, 20 per cent of its liabilities on deposit and current accounts.

The amount of notes issued to each Bank is treated as an advance by the Treasury to that Bank bearing interest from day to day at the current Bank rate, the security for the Treasury advance consisting of a floating charge on the assets of the Bank up to the amount of the notes issued The Bank is permitted to repay the whole or any part of any advance at any time Any amount repaid can be renewed if and when necessity arises, provided that the total amount outstanding at any one time does not exceed the authorized percentage of the Bank's liabilities.

Any sums received by the Bank of England in repayment or advances are either applied forthwith to cancelling any currency notes which have been returned from circulation and are for the time being in the hands of the Bank of England, or, in so far as any such sums may exceed the amount of currency notes returned from circulation in the hands of the Bank of England at the time of receipt, are carried to a separate account in the books of the Bank of England and applied to the cancellation of notes as and when they return from circulation

In order to give the Banks the advantage of the credit allowed under this arrangement even though actual currency may not be required, it is proposed by the amending Bill to take power to issue certificates in lieu of actual notes.

The effect of the issue of these certificates will be that the Banks will be able to obtain credits with the Bank of England on the same terms as currency notes and the expense of printing and handling notes will be avoided except in so far as the notes may be required for actual circulation

(2) Scotland and Ireland

The arrangement in England and Wales applies generally to Scotland and Ireland; but in the case of Banks of Issue in Scotland and Ireland currency notes, instead of being issued to the public, are used as cover for the Banks' own notes. This arrangement has in practice the effect of enabling the Scottish and Irish Banks of Issue to exceed the normal limits of issue of fiduciary notes so long as such excess issues are covered by currency notes.

The new certificates will also be available for the purpose of cover for these issues

A Return of currency notes issued and in circulation will be published each Friday in the London, Edinburgh and Dublin *Gazettes* in the following form—

I —ISSUE ACCOUNT

Total Issues, as shown in last statement—		Notes cancelled as shown in last statement—	
£1 . . .		£1 . .	
10s . . .		10s. . .	
	———		———
Issue during the week.		Cancelled during the week—	
		£1 . .	
		10s. . .	
			———
		Total . .	———
		Outstanding—	
		£1 . .	
		10s. . .	
			———
	———		———
Total . . .	———		———

II.—BALANCE SHEET

Notes outstanding .	Advances—
	Scottish and Irish Banks of Issue .
	Other Bankers . .
	Post Office Savings Bank . . .
	Trustee Savings Banks
	Currency Note Redemption Account

II.—Discounting of Bills by the Bank of England

(1) *Letter from the Chancellor of the Exchequer to the Bank of England dated the 12th August, 1914*

Treasury Chambers,
12th August, 1914.

Gentlemen,

I have the honour to transmit to you herewith a copy of a notice which His Majesty's Government are causing to be published to-morrow, explaining the nature of the arrangement reached after consultation with you to-day for providing Government assistance for the discounting of bills of exchange covered by the Proclamation of the 2nd August, 1914, in regard to postponement of payments

I have the honour to convey to you the authority of His Majesty's Government to take action on their behalf in accordance with the scheme and an assurance that they will in due course ask Parliament to give statutory authority for the arrangements adopted, and for the charge against the Exchequer of any loss which may be incurred by the Bank as the result of their operations in the matter.

I have the honour to be,
Gentlemen,
Your obedient Servant,
(Signed) D LLOYD GEORGE.

The Governor and Deputy-Governor,
Bank of England.

Enclosure to (1)

The Chancellor of the Exchequer has for several days past been in close and constant consultation with the Governor of the Bank of England, the bankers, the accepting houses and the principal traders for the purpose of providing the country with all the banking facilities it needs in the present emergency We are now able to announce that the Chancellor of the Exchequer has completed arrangements with the Bank of England for terminating the present deadlock in the money market and for enabling the trade and commerce of the country to resume its normal course. The greatest difficulty arose from the stoppage of remittances to London both from the provinces and from other countries not only in Europe but in all parts of the world. This caused a breakdown in the

foreign exchanges and deterred bankers from discounting bills in the normal way. To overcome this difficulty as well as that of providing traders in this country with all the banking facilities they need, the Government have now agreed to guarantee the Bank of England from any loss it may incur in discounting bills of exchange either home or foreign, bank or trade, accepted prior to August 4th, 1914. Accordingly we are authorized to make the following announcement—

"The Bank of England are prepared on the application of the holder of any approved bill of exchange accepted before the 4th day of August, 1914 to discount at any time before its due date at Bank rate without recourse to such holder, and upon its maturity the Bank of England will in order to assist the resumption of normal business operations give the acceptor the opportunity until further notice of postponing payment, interest being payable in the meantime at 2 per cent over Bank rate varying Arrangements will be made to carry this scheme into effect so as to preserve all existing obligations

"The Bank of England will be prepared for this purpose to approve such bills of exchange as are customarily discounted by them and also good trade bills and the acceptances of such foreign and colonial firms and bank agencies as are established in Great Britain"

Treasury Chambers, S W.,
12th August, 1914.

(ii) *Letter from Treasury to Bank of England dated 27th August* 1914

Treasury Chambers,
27th August, 1914.

GENTLEMEN,

WITH reference to the letter addressed to the Governors of the Bank by the Chancellor of the Exchequer on the 12th instant on the subject of the discounting by the Bank of England of Bills of Exchange accepted prior to August 4th, I am directed by the Lords Commissioners of His Majesty's Treasury now to place on formal record the arrangement announced in the Press Notice accompanying the letter referred to, as follows—

1 The Bank of England will, upon the application of the holder of any approved bill of exchange accepted before the 4th August 1914, discount such bill at any time before its due date at Bank rate without recourse to such holder

(In the case of date bills the acceptance, if undated, may be deemed to have been given in course of post from the date on which the bills were drawn)

2 It will be for the Bank of England to decide in any particular case whether a bill is to be approved, but the Bank will be prepared to approve such bills of exchange as are customarily discounted by them and also good trade bills and the acceptances of such foreign and colonial firms and bank agencies as are established in Great Britain

3 Upon the maturity of any bill so discounted the Bank of England will give the acceptor the opportunity of postponing payment pending further notice, interest being payable in the meantime at 2 per cent over Bank rate varying.

4. The date at which such further notice shall be given shall be determined by the Bank after consultation with the Treasury.

5. Arrangements will be made for preserving all existing obligations, so far as possible, in respect of bills discounted.

6. The Bank of England are to be indemnified for any action taken by them in the matter, and to be guaranteed by the Treasury against any loss which may be incurred by the Bank as the result of their operations.

7. Such loss is to be calculated in accordance with an account to be kept in the following form—

	£		£
Amount of approved bills discounted at Bank Rate, payment of which has been postponed .		Amount realized by the Bank in respect of approved bills, payment of which has been postponed . .	
Net deficiency . .		Interest received at 2 per cent (above Bank Rate varying) in respect of approved bills, payment of which has been postponed, less allowance to the Bank for interest (at 1 per cent below Bank Rate varying) and expenses (½ per cent) . .	
	£		£

8 The Chancellor of the Exchequer has undertaken to ask Parliament to pass the legislation necessary for giving statutory authority for this scheme, and for charging against the Exchequer the amount of the ultimate loss which may be incurred by the Bank in carrying it into effect

I am to request that my Lords may be informed whether you concur in the statement of the arrangement as set out in this letter

I am, Gentlemen,
Your obedient Servant,
(Signed) JOHN BRADBURY.

The Governor and Deputy-Governor,
Bank of England.

(iii) *Letter from Bank of England to Treasury dated 27th August* 1914

Bank of England, London, E C,
27th August 1914

GENTLEMEN,

I AM directed by the Governors to acknowledge the receipt of Sir John Bradbury's letter of this day's date, setting forth in detail the conditions under which it is desired that the Bank should accept for discount, without recourse to the holders, approved Bills of

Exchange accepted prior to the 4th August, in terms of the announcement published on the 13th inst. by His Majesty's Government

In reply, I am to say that the Bank are prepared to accept for discount such bills as are defined under head (2) on the terms set forth under head (7) and subject to the guarantee by the Treasury against any loss which the Bank may incur as the result of their operations, as expressed under head (6) of the letter under reply

I am, Gentlemen,
Your obedient Servant,
(Sd.) J. G NAIRNE,
Chief Cashier.

The Joint Secretaries to the Treasury,
Treasury Chambers S W.

III.—Extension of Moratorium and Nature of Banking Facilities Available

(1) *Circular in regard to Moratorium and Banking Facilities*

Inland Revenue, Somerset House, London, W C,
19th August 1914.

Sir

The Chancellor of the Exchequer desires to ascertain your views as to the advisability of allowing the moratorium to come to an end on September 4th or of continuing it either wholly or partially for a further period, and he would therefore greatly appreciate your prompt reply to the various questions herein set out.

The questions relate to the moratorium proclaimed for debts contracted before August 4th and falling due and payable between that date and September 4th. Please answer them as simply as possible and add any qualifications or general remarks in the space for that purpose

1 Are you in favour of allowing the present moratorium to end on September 4th ?

2 Are you in favour of extending the present moratorium ?

If yes, state whether you are in favour of extending it—

(a) for an unlimited period,

(b) for a limited and, if so, what period;

(c) for a part of the debt, so as to provide for gradual payment,

(d) in any other and, if so, what way.

3 Qualifications

4 General Remarks

5 Are the banking facilities now available reasonably comparable to those available before the war ?

Signature
Name of Firm
Address
Nature of Business

Inasmuch as the Government have to take an immediate decision we shall be obliged by your sending a reply within 24 hours in the enclosed envelope

Yours faithfully,
H. P. HAMILTON

(ii) *Summary of Replies received up to and including Wednesday, 26th August, 1914*

Classes of Persons sending Returns.	Number of Returns received	Extension of Moratorium beyond 4th September.							Comparison of Banking Facilities Available before the War and now.	
		(1) Number in favour of not Extending	(2) Number in Favour of Extending.						(1) Number of Opinion that Reasonably Comparable	(2) Number of Opinion that not Reasonably Comparable.
			Total Number.	(a) For an Unlimited Period	(b) For a Limited Period.	(c) For a Part of the Debt.	(d) In some other Way			
1. Bankers—										
(a) London	81	3	73	12	62	2	2		42	33
(b) Provinces	42	12	30	5	22	8	1		32	2
2. Stockbrokers—										
(a) London	—	—	—	—	—	—	—		—	—
(b) Provinces	31	6	25	7	17	8	1		26	4
3. Discount Brokers—										
(a) London	17	—	17	16	1	—	—		—	1
(b) Provinces	—	—	—	—	—	—	—		—	—
4. Manufacturers—										
(a) London	741	487	254	43	178	92	3		547	80
(b) Provinces	2,897	1,924	973	160	637	356	16		2,420	180
5. Retail Traders—										
(a) London	243	147	96	18	70	44	1		190	15
(b) Provinces	981	616	365	64	261	168	3		868	27
6. Export Merchants—										
(a) London	227	70	157	58	57	27	6		122	78
(b) Provinces	613	152	461	169	264	87	4		289	249
7 General Merchants										
(a) London	289	139	151	29	104	61	4		174	77
(b) Provinces	1,363	774	589	104	320	248	7		1,076	147
8 Produce Brokers—										
(a) London	45	13	32	6	25	10	3		22	16
(b) Provinces	68	41	27	4	18	4	—		49	5
9 Transport—										
(a) London	93	8	85	8	81	13	—		84	8
(b) Provinces	146	77	69	15	45	12	1		128	7
10. Miscellaneous—										
(a) London	58	22	36	9	20	12	—		34	15
(b) Provinces	321	163	158	17	121	66	1		240	25
[1] Totals	8,256	4,653	3,603	744	2,353	1 219	55		6,341	969

[1] The Committee of the Stock Exchange answering on behalf of their members, numbering approximately 6,000 were unanimously in favour of extension

APPENDIX II

COINAGE ACT, 1920 (10 GEO. 5, Ch 3)

AN ACT to amend the Law in respect of the Standard Fineness of Silver Coins current in the United Kingdom and in other parts of His Majesty's Dominions

[31st March, 1920]

BE it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows—

1.—(1) The first Schedule of the Coinage Act, 1870, as amended by Section two of the Coinage Act, 1891, shall, as regards coins made after the commencement of this Act, have effect as though for the words "thirty seven fortieths fine silver, three fortieths alloy; or millesimal fineness 925," in the column relating to standard fineness there were substituted the words, "one-half fine silver, one half alloy, or millesimal fineness 500," and as though for the figure "4" in the column relating to the remedy allowance in respect of millesimal fineness there were substituted the figure "5."

(2) Where by virtue of a Proclamation made under Section eleven of the Coinage Act, 1870, the whole or any part of that Act is in force in any British possession at the date of the commencement of this Act, that Act shall as from that date apply in that possession as amended by this Act, and any Order in Council or Proclamation directing that any coins which under the Coinage Acts, 1870 and 1891, are legal tender in the United Kingdom shall be current and legal tender in any British possession shall extend to coins which are legal tender in the United Kingdom under those Acts as amended by this Act,

Provided that the provisions of this sub section shall not apply as respects any self governing dominion unless and until those provisions are adopted as regards the dominion by a Proclamation of the Governor-General or Governor

2.—The standard trial plates of silver to be used for the purpose of the trial of the pyx shall, instead of being made of a standard fineness in conformity with the provisions of the Coinage Acts, 1870 and 1891, be made of pure silver

3.—(1) This Act may be cited as the Coinage Act, 1920, and shall be construed as one with the Coinage Acts, 1870 to 1891, and those Acts and this Act may be cited together as the Coinage Acts, 1870 to 1920

(2) In this Act, the expression "self-governing dominion" means the Dominion of Canada, the Commonwealth of Australia, the Dominion of New Zealand the Union of South Africa, and Newfoundland

APPENDIX III

Gold and Silver (Export Control etc.) Act, 1920
(10 & 11. Geo. 5, Ch. 70)

AN ACT to control the exportation of gold and silver coin and bullion, and to prohibit the melting or improper use of gold and silver coin.

[23rd December, 1920.]

Be it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows—

1—(1) Section eight of the Customs and Inland Revenue Act, 1879 (which enables the exportation of certain articles to be prohibited), shall have effect as if, in addition to the articles therein mentioned, there were included the following articles, that is to say, gold or silver coin and gold or silver bullion

(2) If any person acts in contravention of or fails to comply with any condition attached to a licence authorizing the exportation of any goods prohibited to be exported by virtue of this section, he shall for each offence, without prejudice to any other liability, be liable to a Customs penalty of one hundred pounds

(3) Gold produced in any part of His Majesty's Dominions and imported into the United Kingdom under any arrangement approved by the Treasury may, notwithstanding anything in this section, be exported in accordance with the terms of the arrangement.

(4) In this Act the expression "gold or silver bullion" includes gold or silver partly manufactured and any mixture or alloy containing gold or silver

(5) This section shall continue in force until the thirty first day of December, nineteen hundred and twenty-five, and no longer, unless Parliament otherwise determines

2—(1) It shall not be lawful for any person, except under and in pursuance of a licence granted by the Treasury, to melt down, break up, or use otherwise than as currency any gold or silver coin which is for the time being current in the United Kingdom or in any British possession or foreign country

(2) If any person acts in contravention of this section, or acts in contravention of or fails to comply with any condition attached to a licence granted under this section, he shall for each offence, be liable on summary conviction to a fine not exceeding one hundred pounds, or to imprisonment with or without hard labour for a term not exceeding two years, or to both such fine and imprisonment, and, in addition to any other punishment, the Court dealing with the case may order the articles in respect of which the offence was committed to be forfeited

3—This Act may be cited as the Gold and Silver (Export Control, etc.) Act, 1920

APPENDIX IV

Gold Standard Act, 1925 (15 & 16 Geo 5)

CHAPTER 29

AN ACT to facilitate the return to a gold standard and for purposes connected therewith

[13th May, 1925]

Be it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows—

Issue of Gold Coin Suspended and Right to Purchase Gold Bullion

1—(1) Unless and until His Majesty by Proclamation otherwise directs—

(a) The Bank of England, notwithstanding anything in any Act, shall not be bound to pay any note of the Bank (in this Act referred to as "a bank note") in legal coin within the meaning of Section six of the Bank of England Act, 1833, and bank notes shall not cease to be legal tender by reason that the Bank do not continue to pay bank notes in such legal coin:

(b) Subsection (3) of Section one of the Currency and Bank Notes Act, 1914 (which provides that the holder of a currency note shall be entitled to obtain payment for the note at its face value in gold coin), shall cease to have effect.

(c) Section eight of the Coinage Act, 1870 (which entitles any person bringing gold bullion to the Mint to have it assayed, coined and delivered to him), shall, except as respects gold bullion brought to the Mint by the Bank of England, cease to have effect:

(2) So long as the preceding subsection remains in force, the Bank of England shall be bound to sell to any person who makes a demand in that behalf at the Head Office of the Bank during the office hours of the Bank, and pays the purchase price in any legal tender, gold bullion at the price of three pounds, seventeen shillings and tenpence halfpenny per ounce troy of gold of the standard of fineness prescribed for gold coin by the Coinage Act, 1870, but only in the form of bars containing approximately four hundred ounces troy of fine gold

Power for Treasury to Borrow for Exchange Operations

2—(1) Any money required for the purpose of exchange operations in connection with the return to a gold standard may be raised within two years after the passing of this Act in such manner as the Treasury think fit, and for that purpose they may create and issue, either within or without the United Kingdom and either in British or in any other currency, such securities bearing such rate of interest and subject to such conditions as to repayment, redemption or otherwise as they think fit, and may guarantee in

such manner and on such terms and conditions as they think proper the payment of interest and principal of any loan which may be raised for such purpose as aforesaid:

Provided that any securities created or issued under this section shall be redeemed within two years of the date of their issue, and no guarantee shall be given under this Section so as to be in force after two years from the date upon which it is given

(2) The principal and interest of any money raised under this Act, and any sums payable by the Treasury in fulfilling any guarantee given under this Act, together with any expenses incurred by the Treasury in connection with, or with a view to the exercise of, their powers under this Section shall be charged on the Consolidated Fund of the United Kingdom or the growing produce thereof

(3) Where by any Appropriation Act passed after the commencement of this Act, power is conferred on the Treasury to borrow money up to a specified amount, any sums which may at the time of the passing of that Act have been borrowed or guaranteed by the Treasury in pursuance of this Section and are then outstanding shall be treated as having been raised in exercise of the power conferred by the said Appropriation Act and the amount which may be borrowed under that Act shall be reduced accordingly

3.—This Act may be cited as the Gold Standard Act, 1925

APPENDIX V

CURRENCY AND BANK NOTES ACT, 1928 (18 & 19 GEO 5, Ch 13)

CHAPTER 13

AN ACT to amend the law relating to the issue of bank notes by the Bank of England and by banks in Scotland and Northern Ireland, and to provide for the transfer to the Bank of England of the currency notes issue and of the assets appropriated for the redemption thereof, and to make certain provisions with respect to gold reserves and otherwise in connection with the matters aforesaid and to prevent the defacement of bank notes

[2nd July, 1928]

BE it enacted by the King's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons in this present Parliament assembled, and by the authority of the same as follows—

Amendment with respect to powers of Bank of England to Issue Bank Notes

1—(1) Notwithstanding anything in any Act—

(a) The Bank may issue bank notes for one pound and for ten shillings

(b) Any such bank notes may be issued at any place out of London without being made payable at that place, and wherever issued shall be payable only at the Head Office of the Bank:

(c) Any such bank notes may be put into circulation in Scotland and Northern Ireland and shall be current and legal tender in Scotland and Northern Ireland as in England

(2) Section six of the Bank of England Act, 1833 (which provides that bank notes shall be legal tender), shall have effect as if for the words "shall be a legal tender to the amount expressed in such note or notes and shall be taken to be valid as a tender to such amount for all sums above five pounds on all occasions on which any tender of money may be legally made" there were substituted the words "shall be legal tender for the payment of any amount"

(3) The following provisions shall have effect so long as subsection (1) of Section one of the Gold Standard Act, 1925, remains in force—

(a) Notwithstanding anything in the proviso to Section six of the Bank of England Act, 1833 bank notes for one pound or ten shillings shall be deemed a legal tender of payment by the Bank or any branch of the Bank, including payment of bank notes

(b) The holders of bank notes for five pounds and upwards shall be entitled, on a demand made at any time during office hours at the Head Office of the Bank or, in the case of notes payable at a branch of the Bank, either at the Head Office or at that branch, to require in exchange for the said bank notes for five pounds and upwards bank notes for one pound or ten shillings

(4) The Bank shall have power, on giving not less than three months' notice in the London, Edinburgh, and Belfast Gazettes, to call in the bank notes for one pound or ten shillings of any series on exchanging them for bank notes of the same value of a new series

(5) Notwithstanding anything in Section eight of the Truck Act, 1831, the payment of wages in bank notes of one pound or ten shillings shall be valid, whether the workman does or does not consent thereto.

Amount of Bank of England Note Issue

2.—(1) Subject to the provisions of this Act the Bank shall issue bank notes up to the amount representing the gold coin and gold bullion for the time being in the issue department and shall in addition issue bank notes to the amount of two hundred and sixty million pounds in excess of the amount first mentioned in this Section, and the issue of notes which the Bank are by or under this Act required or authorized to make in excess of the said first mentioned amount is in this Act referred to as "the fiduciary note issue."

(2) The Treasury may at any time on being requested by the Bank, direct that the amount of the fiduciary note issue shall for such period as may be determined by the Treasury, after consultation with the Bank be reduced by such amount as may be so determined.

Securities for Note Issue to be Held in Issue Department

3.—(1) In addition to the gold coin and bullion for the time being in the issue department, the Bank shall from time to time appropriate to and hold in the issue department securities of an amount in value sufficient to cover the fiduciary note issue for the time being

(2) The securities to be held as aforesaid may include silver coin to an amount not exceeding five and one half million pounds

(3) The Bank shall from time to time give to the Treasury such information as the Treasury may require with respect to the securities held in the issue department, but shall not be required to include any of the said securities in the account to be taken pursuant to Section five of the Bank of England Act, 1819.

Transfer of Currency Notes Issue to Bank of England

4.—(1) As from the appointed day all currency notes issued under the Currency and Bank Notes Act, 1914, certified by the Treasury to be outstanding on that date including currency notes covered by certificates issued to any persons under Section two of the Currency and Bank Notes (Amendment) Act, 1914, but not including currency notes called in but not cancelled) shall, for the purpose of the enactments relating to bank notes and the issue thereof (including this Act), be deemed to be bank notes, and the Bank shall be liable in respect thereof accordingly

(2) The currency notes to which subsection (1) of this Section applies are in this Act referred to as "the transferred currency notes"

(3) At any time after the appointed day, the Bank shall have power, on giving not less than three months' notice in the London,

Edinburgh, and Belfast Gazettes, to call in the transferred currency notes on exchanging them for bank notes of the same value

(4) Any currency notes called in but not cancelled before the appointed day may be exchanged for bank notes of the same value.

Transfer to Bank of Certain part of Assets of Currency Note Redemption Account

5.—(1) On the appointed day, in consideration of the Bank undertaking liability in respect of the transferred currency notes, all the assets of the Currency Note Redemption Account other than Government securities shall be transferred to the issue department, and there shall also be transferred to the issue department out of the said assets Government securities of such an amount in value as will together with the other assets to be transferred as aforesaid represent in the aggregate the amount of the transferred currency notes

For the purpose of this subsection the value of any marketable Government securities shall be taken to be their market price as on the appointed day less the accrued interest, if any, included in that price

(2) Any bank notes transferred to the Bank under this section shall be cancelled

(3) Such of the said Government securities as are not transferred to the Bank under the foregoing provisions of this Section shall be realized and the amount realized shall be paid into the Exchequer at such time and in such manner as the Treasury direct

Profits of Note Issue to be Paid to Treasury

6.—(1) The Bank shall, at such times and in such manner as may be agreed between the Treasury and the Bank, pay to the Treasury an amount equal to the profits arising in respect of each year in the issue department, including the amount of any bank notes written off under Section six of the Bank Act, 1892, as amended by this Act, but less the amount of any bank notes so written off which have been presented for payment during the year and the amount of any currency notes called in but not cancelled before the appointed day which have been so presented

(2) For the purposes of this Section the amount of the profits arising in any year in the issue department shall, subject as aforesaid, be ascertained in such manner as may be agreed between the Bank and Treasury

(3) For the purposes of the Income Tax Acts, any income of, or attributable to, the issue department shall be deemed to be income of the Exchequer, and any expenses of, or attributable to, the issue department shall be deemed not to be expenses of the Bank.

(4) The Bank shall cease to be liable to make any payment in consideration of their exemption from stamp duty on bank notes.

7. Section six of the Bank Act, 1892 (which authorizes the writing off of bank notes which are not presented for payment within forty years of the date of issue), shall have effect as if, in the case of notes for one pound or ten shillings twenty years were substituted for forty years, and as if, in the case of any such notes being transferred currency notes, they had been issued on the appointed day and, in the case of any such notes not being transferred currency notes, they had been issued on the last day on which notes of the particular series of which they formed part were issued by the Bank.

Power to Increase Amount of Fiduciary Note Issue

8.—(1) If the Bank at any time represent to the Treasury that it is expedient that the amount of the fiduciary note issue shall be increased to some specified amount above two hundred and sixty million pounds, the Treasury may authorize the Bank to issue bank notes to such an increased amount, not exceeding the amount specified as aforesaid, and for such period, not exceeding six months, as the Treasury think proper

(2) Any authority so given may be renewed or varied from time to time on the like representation and in like manner

Provided that, notwithstanding the foregoing provision, no such authority shall be renewed so as to remain in force (whether with or without variation) after the expiration of a period of two years from the date on which it was originally given unless Parliament otherwise determines.

(3) Any minute of the Treasury authorizing an increase of the fiduciary note issue under this Section shall be laid forthwith before both Houses of Parliament

Amendment as to Issue of Notes by Banks in Scotland and Northern Ireland

9.—(1) For the purpose of any enactment which in the case of a bank in Scotland or Northern Ireland limits by reference to the amount of gold and silver coin held by any such bank the amount of the notes which that bank may have in circulation, bank notes held by that bank or by the Bank on account of that Bank shall be treated as being gold coin held by that bank

(2) A bank in Scotland or Northern Ireland may hold the coin and bank notes by reference to which the amount of the bank notes which it is entitled to have in circulation is limited at such of its offices in Scotland or Northern Ireland, respectively, not exceeding two, as may from time to time be approved by the Treasury

10.—The form prescribed by Schedule A to the Bank Charter Act, 1844, for the account to be issued weekly by the Bank under Section six of that Act may be modified to such an extent as the Treasury, with the concurrence of the Bank, consider necessary, having regard to the provisions of this Act

Power of Bank of England to Require Persons to Make Returns of and to Sell Gold

11.—(1) With a view to the concentration of the gold reserves and to the securing of economy in the use of gold, the following provisions of this section shall have effect so long as subsection (1) of Section one of the Gold Standard Act, 1925, remains in force.

(2) Any person in the United Kingdom owning any gold coin or bullion to an amount exceeding ten thousand pounds in value shall, on being required so to do by notice in writing from the Bank, forthwith furnish to the Bank in writing particulars of the gold coin and bullion owned by that person, and shall, if so required by the Bank, sell to the Bank the whole or any part of the said coin or bullion, other than any part thereof which is bona fide held for immediate export or which is bona fide required for industrial purposes, on payment therefor by the Bank, in the case of coin, of the nominal value thereof, and in the case of bullion, at the rate fixed in Section four of the Bank Charter Act, 1844

Penalty for Defacing Bank Notes

12.—If any person prints, or stamps, or by any like means impresses, on any bank note any words, letters or figures, he shall, in respect of each offence, be liable on summary conviction to a penalty not exceeding one pound.

Short Title, Interpretation and Repeal

13.—(1) This Act may be cited as the Currency and Bank Notes Act, 1928.

(2) This Act shall come into operation on the appointed day, and the appointed day shall be such day as His Majesty may by Order in Council appoint, and different days may be appointed for different purposes and for different provisions of this Act.

(3) In this Act, unless the context otherwise requires—

The expression "the Bank" means the Bank of England;

The expression "issue department" means the issue department of the Bank;

The expression "bank note" means a note of the Bank;

The expression "coin" means coin which is current and legal tender in the United Kingdom;

The expression "bullion" includes any coin which is not current and legal tender in the United Kingdom.

(4) The enactments set out in the Schedule to this Act are hereby repealed to the extent specified in the third column of that Schedule.

SCHEDULE

Enactments Repealed

Session and Chapter	Short Title	Extent of Repeal
7 & 8 Vict. c 32	The Bank Charter Act, 1844	Sections two, three, five and nine, in Section eleven the words from 'save and except that ' to the end of the Section, Sections thirteen to twenty, and Section twenty-two and, so far as relates to England, Sections ten and twelve
24 & 25 Vict c. 3	Bank of England Act, 1861	Section four, so far as unrepealed
4 & 5 Geo. 5 c 14	The Currency and Bank Notes Act, 1914	The whole Act, except subsection (5) of Section one and Section five
4 & 5 Geo. 5. c. 72.	The Currency and Bank Notes (Amendment) Act, 1914	The whole Act
5 & 6 Geo 5 c. 62	The Finance Act, 1915	Section twenty-seven.
15 & 16 Geo. 5 c 29.	The Gold Standard Act, 1925.	Paragraph (*b*) of subsection (1) of Section one

APPENDIX VI

THE GOLD STANDARD (AMENDMENT) ACT, 1931

1.—(1) Unless and until His Majesty by Proclamation otherwise directs, Sub-section (2) of Section 1 of the Gold Standard Act, 1925, shall cease to have effect, notwithstanding that Sub-section (1) of the said Section remains in force

(2) The Bank of England are hereby discharged from all liabilities in respect of anything done by the Bank in contravention of the provision of the said Sub-section (2) at any time after the eighteenth day of September, nineteen hundred and thirty one, and no proceedings whatsoever shall be instituted against the Bank or any other person in respect of anything so done as aforesaid

(3) It shall be lawful for the Treasury to make, and from time to time vary, orders authorizing the taking of such measures in relation to the exchanges and otherwise as they may consider expedient for meeting difficulties arising in connexion with the suspension of the Gold Standard

This Sub-section shall continue in force for a period of six months from the passing of this Act

2.—This Act may be cited as the Gold Standard (Amendment) Act, 1931

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C8—(B 1543)